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Vol 317

No. 16700

In the United States Court of Appeals for the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

JEFFRIES BANKNOTE COMPANY, RESPONDENT

ON PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

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JURISDICTION

This case is before the Court upon the petition of the National Labor Relations Board pursuant to Section 10(e) of the National Labor Relations Act, as amended (61 Stat. 136, 73 Stat. 519, 29 U.S.C., Sec. 151 *et seq.*),[1] for enforcement of its order issued against respondent on September 15, 1959. The Board's decision and order (R. 47–51)[2] are reported at 124 NLRB No. 117. This Court has jurisdiction of the proceeding under Section 10(e) of the Act, the unfair labor practices having occurred within this

[1] The relevant provisions of the Act are printed in the Appendix, *infra*, pp. 28–30.

[2] Reference to portions of the printed record are designated "R." Wherever a semicolon appears, the references preceding it are to the Board's findings; those following are to the supporting evidence.

judicial circuit at Los Angeles, California, where respondent is engaged in commercial printing for financial firms (R. 15–16; 8, 12).

STATEMENT OF THE CASE

Briefly, the Board found that respondent violated Section 8(a) (5) and (1) of the Act by refusing to execute a collective bargaining agreement which had been negotiated on its behalf by the employers' association to which it belonged and through which it participated in a multi-employer bargaining relationship with the representative of its employees. The evidentiary facts upon which this finding rest may be summarized as follows:[3]

I. The Board's findings of fact

A. The multi-employer bargaining relationship respecting commercial printing firms in Los Angeles, and respondent's participation therein

For many years collective bargaining between lithographic employees and the majority of commercial printing companies in Los Angeles, has been conducted on a multi-employer basis (R. 16; 75). The employees have been represented by Amalgamated Lithographers of America, Local 22, AFL–CIO, hereafter called the Union, and the printing companies have been represented by the Union Em-

[3] The proceeding against respondent was consolidated before the Board with another case involving a different employer, Anderson Lithograph Company, but substantially the same factual background. Accordingly, the Trial Examiner's Intermediate Report and the Board's Decision and Order treat both cases together. Anderson Lithograph Company has complied with the Board's order, with the consequence that the instant proceeding is restricted to that part of the Decision and Order relating only to respondent.

ployers' Section of the Printing Industries Association, hereafter called the Association (R. 16; 64, 75). Members of the Association are signatory to authorization forms which provide that the Association, through a negotiating committee selected by its membership, shall act as the representative of all members in bargaining matters and that any agreement reached by it with the Union shall be "binding upon each [member] Company" if ratified by a majority of the members.[4]

In the fall of 1957, in accordance with past practice, the Union notified the Association, and the 46 companies it then represented, that it wished to begin negotiations for a new contract to succeed the existing agreement which was to expire in February, 1958

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[4] In relevant part the authorization form reads as follows (R. 61, 160):

"The undersigned _____ authorizes the [Association] to act as its collective bargaining agent in negotiating with the [Union] a tentative agreement covering wages, hours and other conditions of employment.

"If the Association reaches such tentative agreement, it shall be referred to a meeting of those companies signing this authorization, and in the event a majority of said companies attending this meeting ratify its terms, the Association shall then execute a formal contract with the Union binding upon each Company signing this authorization.

"It is further agreed by the undersigned _____ that it will refrain from entering into any individual negotiation, contract, or understanding with the Union, and that it will comport itself in a manner consistent with preserving Association unity.

* * * * *

"This authorization may be revoked after the execution of a contract between the Association and the Union by submission of written notice to [Association]. * * *"

(R. 17; 73, 133–134). At this time respondent, which had been a member of the Association in 1951, was not affiliated with the Association and dealt with the Union separately (R. 18; 72–73, 114). Respondent's contract with the Union, like that of the Association, was to expire in February, 1958, and respondent accordingly carried on separate negotiations with the Union during the winter of 1957–1958 concurrently with those between the Union and the Association (R. 18; 72–73).

Neither set of negotiations produced agreement before the termination of the existing contracts (R. 17–18; 98–100, 135). The principal unresolved issues between respondent and the Union related to a union security provision and the application to lithographic employees of a profit-sharing plan enjoyed by some of respondent's employees (R. 73, 98–99, 114–115). On March 14, 1958, respondent decided to abandon separate negotiations with the Union, and to participate in the bargaining conducted by the Association. Accordingly, on that date it notified both the Association and the Union that "Jefferies Banknote Company has designated the [Association] as its collective bargaining representative and will henceforth be represented in any negotiations by them" (R. 17; 116, see also 164–165). Separate negotiations between respondent and the Union thereafter ceased, and it was understood by all parties that the Association spoke for respondent as well as its other members in conducting subsequent negotiations with the Union (R. 18; 71–72, 116–117).

B. The Association and the Union reach agreement on the terms of a new collective bargaining contract

On March 20, 1958, about a week after respondent had authorized the Union to represent it in bargaining matters, the Union called a strike against all Association members, including respondent, in support of its bargaining position (R. 19; 66, 79–80). Substantially all of the employees represented by the Union joined in the strike (R. 19). During the first week of the strike several of the Association members, without informing the Association, concluded separate agreements with the Union (R. 19–20; 80–83). Upon learning of this development, an emergency meeting of the Association's negotiating committee was called for March 26, 1958, and it was there decided that a full membership meeting should be held the following day (R. 19–20; 136–138).

At the membership meeting on March 27 the negotiating committee reported the defections among the Association's membership, and the terms of the individual agreements which had been executed (R. 20; 138–139). The committee's spokesman then stated that it was the committee's recommendation that in view of the separate contracts which had been signed, "it would be inadvisable to continue the strike" (R. 20; 139). The membership was asked to "ratify in advance" a settlement offer containing the same terms as those embodied in the separate contracts, but the committee's spokesman also stated that any member which wished to withdraw from the Association rather than be bound by its contract position could do so by signing a form provided for that purpose (R. 20–21;

128, 132, 139, 140). The membership then adopted by a majority vote the committee's recommendation, but two of the member companies signed the revocation forms (R. 20–21; 132, 139, 140).

Respondent did not withdraw from the Association at the March 27 meeting, but its representative told the negotiating committee after the meeting had ended that it would "go along" with the proposed contract if it did not contain a profit sharing plan (R. 21; 125–126, 140–141, 148–149). Such a plan was included in the proposed agreement which had been described to the meeting and recommended by the negotiating committee, and which had been accepted by the vote of the membership of the Association (R. 167).[5]

Immediately following the Association meeting of March 27, the negotiating committee met with Union representatives. In a preliminary conversation the committee advised the Union president, Theodore Brandt, of respondent's position, as stated to the committee, respecting the profit-sharing proposal, but Brandt declined to acquiesce in any effort by respondent to escape the binding effect on it of any agreement reached between the Association and the

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[5] The plan, as proposed by the Union, provided that any employer having a profit sharing arrangement covering factory employees would "permit but not compel any member of the bargaining unit, who desires, to participate in the said plan" (R. 18; 167). The Union first added this plan to its contract proposals submitted to the Association after respondent had designated the Association to represent it on March 14, 1958 (R. 18; 64–65, 79). The Union had proposed, in its earlier separate negotiations with respondent, that the profit-sharing plan then in effect at respondent's plant be extended to cover the lithographic employees (*supra*, p. 4).

Union (R. 21–22; 142, 74, 108, 155).[6] The committee then offered to enter into a contract upon the terms its members had just ratified, including the profit-sharing provision, and the Union accepted (R. 21–22; 87–88, 141, 167). The Union membership ratified the agreement the same afternoon (R. 88, 142).

C. Respondent's refusal to execute the contract negotiated by the Association and the Union

On April 1, 1958, Brandt spoke with respondent's president Allerton Jeffries, about returning the striking employees to their jobs. Jeffries stated that he would agree to take the employees back as work became available at the new wage rate negotiated by the Association, but suggested that a complete contract be negotiated between the Union and respondent (R. 23–24; 90–91, 102–103, 120). Brandt answered that the relationship between respondent and the Union was complicated, and that he wished to consult with the Union's attorney (*ibid.*). On April 2, in a letter to the Union, respondent restated its position as to the recalling of the striking employees and negotiating a new contract (R. 24; 170–171). In answer, the Union wrote respondent as follows (R. 24–25; 172–173):

[6] Brandt's response when told that respondent wished to qualify its representation by the Association was the subject of radically differing testimony at the hearing, ranging from testimony that Brandt stated the matter would be taken up in individual negotiations with respondent (R. 151–152, 157), to testimony that Brandt remained silent (R. 142), to testimony that Brandt stated respondent would be bound by any agreement made by the Association (R. 74, 108, 155). The Trial Examiner concluded that "Brandt made no statement at this meeting reasonably construed as acquiesence in Jeffries' revocation of (Association) authority" (R. 22).

> We are, of course, expecting that the wage increases will be instituted in your plant as of February 15, 1958, in accordance with the negotiations just concluded.
>
> I am puzzled by your statement that you wish to start negotiations with Local 22.
>
> During negotiations with the Printing Industries Association, on behalf of the Lithographic Employers in Los Angeles, you advised Local 22, in writing, that the Association was bargaining for you as well as on behalf of the various other employers.
>
> Accordingly, we must proceed on the assumption that there is no need for further negotiations, and that we may expect from you a signed contract in accordance with the terms agreed upon in the general negotiations.

No further negotiations were conducted between the Union and respondent, as far as the record shows. In due course, the Association members which had accepted the contract executed individual copies thereof circulated by the Union (R. 23; 71, 91). Respondent, however, refused to execute the copy of the contract furnished it (R. 23; 71).

II. The Board's conclusions and order

Upon the foregoing facts, the Board concluded that respondent had authorized the Association to negotitiate an agreement with the Union on its behalf, and had not unconditionally withdrawn from the multi-employer bargaining relationship at the time that agreement was reached between the Association and the Union. In these circumstances, the Board found that respondent was precluded by the good faith bar-

gaining requirements of the Act from rejecting the "agreement made by the multi-employer group with which [it] was then affiliated," and that its action in this respect constituted a violation of Section 8(a) (5) and (1) of the Act. The Board further noted that, in view of these findings, it was unnecessary to decide whether an unconditional withdrawal from multi-employer bargaining would in any event, in the circumstances of this case, be permitted under the bargaining provisions of the Act (R. 48–49).

The Board's order requires respondent to cease and desist from refusing to execute the agreement negotiated by the Association and the Union in this case, or from in any like or related manner interfering with the rights of its employees to bargain collectively through the representative of their choice. Affirmatively, the Board's order requires respondent to execute the collective bargaining agreement reached between the Association and the Union and to post appropriate notices (R. 49–51).

SUMMARY OF ARGUMENT

The good faith bargaining provisions of the Act expressly require an employer to execute a collective bargaining contract entered into on his behalf by an agent authorized to represent him in bargaining matters. The present case involves the application of this settled principle to a situation where the employer's authorized bargaining agent was a multi-employer bargaining association. In such a situation it is particularly important that all members be required to execute a contract negotiated on their be-

half, for the effectiveness of the group bargaining technique depends on the uniform coverage of the contract within the bargaining unit.

It is plain from the record that respondent originally authorized the Association to reach binding agreements on its behalf, and that the Association did reach such an agreement, which respondent refused to execute. Respondent urged before the Board, however, that it effectively qualified the Association's authority to represent it and was thereby released from commitments contrary to such qualifications thereafter made by the Association on behalf of its members. In addition respondent contended that the defections on the part of some Association members in signing individual contracts with the Union terminated the Association's authority to represent any member; and that, in any event, the Union acquiesced in respondent's refusal to be party to the Association contract. None of these contentions is meritorious.

1. Respondent did not attempt to withdraw completely from the Association, but instead attempted to qualify substantively the authority of the Association to make a particular concession. The Association, however, was organized to operate by majority rule, and its procedures did not permit such individual limitations where, as here, the majority of the members had approved of the contract proposal in question. Moreover, respondent's attempt to qualify the Association's authority to bargain on its behalf directly conflicts with the Board's established rule that "the intention by a party to withdraw [from a multi-

employer bargaining unit] must be unequivocal * * *'' *Retail Associates, Inc.,* 120 NLRB 388, 393. The basic consideration underlying this limitation upon the independent action allowed to an employer participating in group bargaining is that deference must be given to the larger statutory interest in promoting industrial stability in multi-employer bargaining relationships. The central feature of multi-employer bargaining is the standardization of contract terms, plainly a consequence of a uniform bargaining position on the part of the employer members. If each of the 47 members of the Association involved here could separately qualify its authorization as respondent attempted, the resulting non-uniformity would be the antithesis of multi-employer bargaining; the result "would render the general and widely-recognized practice of multi-employer bargaining virtually valueless'' (R. 48). Accordingly, the Board's decision here, in giving effect to rules without which multi-employer bargaining could not function, reflects a reasonable "balancing of the conflicting interests'' involved in multi-employer bargaining, a responsibility which in this area of "national labor policy * * * Congress committed primarily to the National Labor Relations Board, subject to limited judicial review.'' *N.L.R.B.* v. *Truck Drivers Local 449,* 353 U.S. 87, 96.

2. Respondent's contention that the Association's authority as representative for its members was automatically nullified when several of the members signed individual contracts during the strike is not supported

by the facts. Both before and after such defections in the Association membership, the Association continued to speak for the bargaining unit, as contemplated by all parties involved. Further, the notion that a multi-employer bargaining relationship is subject to dissolution at any point in negotiations by the independent actions of a small group of employers within the unit is contrary to the relevant principles of good faith bargaining in a multi-employer unit, as stated above.

There is no need to consider whether there was any impropriety on the part of the Union and the Association members which executed separate agreements. The issue here is not what rights respondent may have *vis a vis* the Union and these employers, but whether respondent had effectively removed itself from the multi-employer unit—an issue which must be resolved, as shown, against respondent's position.

3. Respondent's final contention before the Board was that the Union agreed that respondent should not be bound by the March 27 agreement. The contention, however, rests simply on a credibility resolution by the Trial Examiner, which in the circumstances of this case is not subject to reversal on judicial review.

ARGUMENT

The Board properly determined that respondent violated Section 8(a) (5) and (1) of the Act by refusing to execute the collective bargaining contract negotiated by the Association for its members

A. Introduction—the issues defined

The controlling legal principle upon which the Board's decision rests is that the good faith bargain-

ing provisions of the Act require an employer to execute a collective bargaining contract entered into on his behalf by a multi-employer association which is authorized to represent him in bargaining matters. This principle derives directly from the language of the statute. Thus, Section 8(d) of the Act explicitly defines the statutory duty "to bargain collectively" to include "the execution of a written contract incorporating any agreement reached if requested by either party." See also *Heinz Co.* v. *N.L.R.B.,* 311 U.S. 514, 526. That the same requirement is applicable in situations where, as here, agreement with a union has been reached by an authorized representative of an employer, acting on his behalf, is settled by this Court's decisions in *N.L.R.B.* v. *Shannon & Simpson Casket Co.,* 208 F. 2d 545, 548, and *N.L.R.B.* v. *Nesen,* 211 F. 2d 559, 563–564, certiorari denied, 348 U.S. 820. See also, *N.L.R.B.* v. *Gittlin Bag Co.,* 196 F. 2d 158, 159 (C.A. 4). Indeed, it is particularly important that the statutory requirement respecting the execution of written agreements be enforced with respect to members of a multi-employer bargaining unit. Bargaining in this situation affects large numbers of employers and their employees, and the effectiveness of this basis for bargaining, which, as the Supreme Court has noted, has been considered "a vital factor in the effectuation of the national policy of promoting labor peace through strengthened collective bargaining," depends in large measure upon adherence by all employers involved to collective agreements concluded at the group level. *N.L.R.B.* v. *Truck Drivers Local*

449, 353 U.S. 87, 95. See the discussion at pp. 17–22, *infra.*

In the present case it is not open to dispute that respondent, when it joined the Association on March 14, 1958, vested full authority in the Association to represent it in bargaining with the Union, and to reach a binding agreement on its behalf. Respondent formally notified the Union that it would "henceforth be represented in any negotiations by [the Association]," and separate negotiations between respondent and the Union were at once discontinued (*supra,* p. 4). Similarly, it cannot be questioned that the Association reached full agreement, ratified by a majority of the Association's members, in its negotiations with the Union on March 27, 1959 (*supra,* pp. 5–7).[7]

From the foregoing it is plain that respondent's statutory obligation to bargain in good faith with the Union required it to execute the contract of March 27 if respondent was at that time a member of the Association, and thus within the multi-employer bargaining unit. Respondent contended before the Board, however, that the Association was no longer in a position on March 27 to bind it to the agreement which it reached with the Union on that date. The contention is based primarily on respondent's state-

[7] The Association's usual practice, as reflected by the standard authorization form signed by its members, was to obtain ratification of its members after reaching agreement with the Union (*supra*, p. 3, n. 4). Since the Association obtained advance approval of the precise terms of the agreement reached in this case, the agreement of course became effective and binding on the Union and all Association members as soon as it was concluded.

ment to the Association's negotiating committee at the March 27 membership meeting that respondent would "go along" with the proposed contract only if it did not contain a profit-sharing provision (*supra*, p. 6). Accordingly, the question presented on this phase of the case is whether respondent's attempt to qualify the Association's authority to represent it was effective so as to release respondent from commitments thereafter made by the Association on behalf of its members. Two additional contentions were also advanced before the Board by respondent in support of its position that it was not subject to the March 27 agreement. Thus, respondent argued that the defections on the part of some Association members in signing individual contracts with the Union had the effect of dissolving the Association and terminating its authority to represent any of the members, including respondent. Finally, it was argued before the Board that even if the Association was authorized to represent respondent, the Union had acquiesced in respondent's refusal to be party to the Association contract, thereby releasing respondent from its coverage.

We deal with each of these contentions below.

B. Respondent was a member of the multi-employer bargaining unit when the March 27 agreement was reached, and was therefore bound by the agreement

1. *Respondent's attempt to qualify the Association's authority to represent it was ineffective*

When respondent notified the Association's negotiating committee on March 27, that it did not approve of the Union's profit-sharing proposal, it knew that a number of the Association's members had signed indi-

vidual contracts embodying such a provision, and that the same provision had been expressly approved by a majority vote of the membership (*supra,* pp. 5–6). In addition, the spokesman for the negotiating committee had announced that any members wishing to revoke the Association's authority to represent them could do so by signing a form provided for that purpose (*supra,* p. 5). Respondent, however, did not withdraw from the Association, as did some of the other members when the foregoing announcement was made, nor did it in any way indicate to the negotiating committee that the Association could not speak for it in negotiating an agreement with the Union. Instead, respondent attempted to qualify substantively the authority of the Association to make a particular concession insofar as its applicability to respondent was concerned. Accordingly, the question on this phase of the case is not whether an employer may completely withdraw from a multi-employer bargaining unit during bargaining negotiations. Rather, the question is whether an employer who remains in the bargaining unit and continues to authorize the employer association to speak for it may escape the application to it of an agreement thereafter made by the Association which contains a provision which the employer has specially disapproved but which was expressly adopted by a majority of the members of the Association.

It is clear that nothing in the arrangement between the Association and its members affords respondent the kind of immunity it seeks. The standard authorization form used by Association members provides that the Association, upon ratification by a majority

of its members of its agreement with the Union, "shall * * * execute a formal contract with the Union binding upon each Company * * *" (R. 61; 160). In like vein, the Association represented to the Union at the outset of contract negotiations that the negotiating committee was authorized "at the conclusion of negotiations to execute in the name of the [Association] a collective bargaining agreement binding upon each and every firm it represents" (R. 169–170). The only provision for revocation by members of their authorizations to the Association called for "submission of written notice * * * after the execution of a contract" (R. 160). Thus, insofar as the relationship between respondent and the Association is concerned, respondent's failure to withdraw completely from the Association left the latter free to negotiate an agreement binding upon respondent, even though respondent had expressed its opposition, as a minority member of the Association, to one of the proposed provisions of the contract with the Union.

As respondent has failed to establish its right under Association procedures to restrict specially the authority of the Association to negotiate on its behalf, it can prevail only if the Act in some way protects the right to a limited participation by an employer in multi-employer bargaining. The Act itself does not expressly deal with problems relating to multi-employer bargaining. The bargaining provisions of the Act nonetheless contemplate freedom by employers and unions to make full use of this kind of bargaining relationship. Thus, noting the widespread prac-

tice of bargaining through employer associations, the Supreme Court has explained (*N.L.R.B.* v. *Truck Drivers Local 449,* 353 U.S. 87, 95–96):

> The inaction of Congress with respect to multi-employer bargaining cannot be said to indicate an intention to leave the resolution of this problem to future legislation. Rather, the compelling conclusion is that Congress intended "that the Board should continue its established administrative practice of certifying multi-employer units, and intended to leave to the Board's specialized judgment the inevitable questions concerning multi-employer bargaining bound to arise in the future".[26]

[26] 231 F. 2d at 121 (dissenting opinion).

See also *Davis Furniture Co.* v. *N.L.R.B.,* 197 F. 2d 435, 438 (C.A. 9).

In the performance of its obligation thus to exercise its "specialized judgment" in formulating the rules which govern withdrawal from multi-employer bargaining, the Board has attempted, as the touchstone of decision, to foster the stable and responsible industrial relationship which is the purpose of such bargaining. As stated by the Board in *Retail Associates,* 120 NLRB 388, 393:

> The right of withdrawal by either a union or employer from a multi-employer unit has never been held, for Board purposes, to be free and uninhibited, or exercisable at will or whim. For the Board to tolerate such inconstancy and uncertainty in the scope of collective-bargaining units would be to neglect its function in delineating appropriate units under Section 9, and to ignore the fundamental purpose of the

> Act of fostering and maintaining stability in bargaining relationships. Necessarily under the Act, multi-employer bargaining units can be accorded the sanction of the Board only insofar as they rest in principle on a relatively stable foundation.[8]

The same principles apply in determining whether an employer, although not unequivocally withdrawing from multi-employer bargaining, may condition further representation by the employer Association upon the adoption of specified substantive contract terms. That is, the extent of independent action which is allowed to an employer who participates in group bargaining is governed by the larger statutory interest in promoting industrial stability in multi-employer bargaining relationships.

The central feature of multi-employer bargaining is the standardization of contract terms for the employers within the bargaining unit—the consequence of a uniform bargaining position on the part

[8] The Board further indicated in the *Retail Associates* decision, in accordance with the principles stated in the text, that absent unusual circumstances, it would not permit abandonment of a multi-employer unit by an employer "Where actual bargaining negotiations based on the existing multi-employer unit have begun." 120 NLRB at 395. Accordingly, even if respondent in the present case had fully withdrawn from the bargaining unit, it would appear that its action would not have been effective insofar as the Act is concerned, at least absent "unusual circumstances." As stated *supra*, p. 9, the Board noted that it was not necessary to pass on the question of whether such justifying circumstances were present in this case, since respondent did not purport to revoke completely the Association's authority to speak for it in negotiations with the Union. If the Court should view respondent's action in this case as an attempt to remove itself altogether from the bargaining unit, it would appear appropriate to remand the case to the Board on consideration of this undecided question.

of the employers involved. See *N.L.R.B.* v. *Truck Drivers Local 449,* 353 U.S. 87, 94–96. Such standardization has promoted industrial stability; strikes have tended to be infrequent in multi-employer units.[9] It is at once apparent, however, that uniformity of contractual terms is impossible if the bargaining authority of the employers' representative may be qualified by individual employers in the unit. If respondent could qualify its representation by the Association in this case upon elimination of the profit sharing proposal, so might the other 46 employer members of the Association qualify their representation upon adoption or rejection of other substantive matters. The resulting nonuniformity of employer position is the antithesis of multi-employer bargaining, and would defeat its underlying purpose of standardizing contract terms within the unit. As stated by the Board, to reserve such freedom of individual action "would render the general and widely-recognized practice of multi-employer bargaining virtually valueless" (R. 48).

In short, multi-employer bargaining can only be meaningful, and thereby function as contemplated by

[9] Monthly Labor Review, vol. 64, p. 397 (Bureau of Labor Statistics, 1947); Zorn, Multi-Plant and Multi-Employer Bargaining (Sixth Annual Conference on Labor, N.Y.U., 1953), p. 385, 401; *Causes of Industrial Peace, Final Report* (National Planning Association, 1953), pp. 11, 18; Kerr and Fisher, *Multiple Employer Bargaining: The San Francisco Experience* (Institute of Industrial Relations, Univ. of Calif., 1948), p. 53; Kerr and Randall, *Multiple Employer Bargaining in the Pacific Coast Pulp and Paper Industry* (Institute of Industrial Relations, Univ. of Pa., 1948), pp. 27–31; Witte, *Economic Aspects of Industry-Wide Collective Bargaining* (Department of American Studies, Amherst College, 1950), pp. 50–51.

the bargaining provisions of the Act, where the employer members are bound by the agreement concluded on their behalf by their representative. Good faith bargaining requires no less. No purpose can be served by negotiations on a multi-employer basis if employers may renege at the conclusion of bargaining because of some private qualification placed on the authority of their representative. The statutory "process [which looks] to the ordering of the parties' industrial relationship through the formation of a contract" is not furthered by permitting employers, as exemplified by respondent's conduct in this case, to slip from individual bargaining to group bargaining and back again, as it suits their interests, depending on whether one or the other methods is more likely to result in the particular contract terms they desire. *N.L.R.B.* v. *Insurance Agents' Union,* 361 U.S. 477, 485. It is true, of course, that group bargaining as viewed by the Board involves application of the principle of majority rule, even though individual employers may thereby become parties to contractual terms of which they did not approve. Multi-employer bargaining, however, cannot be carried on within the intendment of the Act unless majority rule is operative. As stated above, if a minority of employers within the unit are free to reject contract provisions approved by a majority, uniformity of contract terms is destroyed, and the essential purpose of group bargaining is thereby nullified. The conflict between private and group interest may properly be resolved in favor of "preservation of the integrity of the multi-employer

bargaining unit" in the situation presented by the instant case, just as the analogous conflict between the interests in striking and group bargaining was similarly resolved in *N.L.R.B.* v. *Truck Drivers, Local 449,* 353 U.S. 87, 93.

From the foregoing, it is apparent that as a minimum multi-employer bargaining presupposes an identified unit in which the ultimate agreement will be uniformly applicable. Accordingly, "the Board has repeatedly held over the years that the intention by a party to withdraw [from a multi-employer bargaining unit] must be unequivocal * * *" *Retail Associates, Inc.,* 120 NLRB 388, 393. So long as the employer group is authorized to speak for an employer in bargaining matters, as was the situation respecting the Association and respondent in the present case, the employer cannot escape the binding effect of the agreement thereafter reached. These basic precepts reflect a fully reasonable "balancing of the conflicting legitimate interests" involved in multi-employer bargaining, a function which in this area of "national labor policy * * * Congress committed primarily to the National Labor Relations Board, subject to limited judicial review." *N.L.R.B.* v. *Truck Drivers Local 449,* 353 U.S. 87, 96. Applying the foregoing principles to this case, it is plain that respondent's effort to qualify the authority of the Association to represent it was ineffective, and that respondent, like all other employers in the bargaining unit for which the Association spoke, was required by the Act to execute the contract negotiated between the Association and the Union.

2. The defections by some Association members in signing individual contracts did not dissolve the Association and thereby abrogate its authority to conclude an agreement covering the bargaining unit

Respondent contended before the Board that, whether or not it could properly qualify the Association's authority to bargain for it, the Association's authority in this respect was automatically nullified when several of the Association members signed individual contracts during the strike. Respondent reasons that the authorization of each member to the Association was impliedly conditioned upon the continued adherence of every other member to the group bargaining principle, and that the breach of this obligation by some of the members had the effect of terminating all bargaining authority of the Association.

Neither the arrangement between the Association and its members or their conduct afford the slightest support for respondent's attenuated theory. The authorization forms signed by the Association members provided for only one method of releasing members from group actions—by written revocation. Even in the event of such a revocation moreover, the authorization forms do not suggest that the result would be a dissolution of the Association, or a nullification of its capacity to represent the remaining members. There is no apparent reason for treating an unauthorized defection from the Association differently. Certainly no such extreme consequence was contemplated by the parties. The Association itself protested to the Union when it learned of individual negotiations between the Union and Association members, and strongly asserted its continuing and exclusive authority to repre-

sent all such members (R. 162–163). Moreover, there is no indication that any of the employers involved thought that the independent actions by some of their fellow members in any way lessened the Association's authority as their representative. Indeed, on March 27 when Association members were given an opportunity to withdraw altogether from multi-employer negotiations, only a very few followed this course, and as shown, respondent was not one of them (*supra,* pp. 5–6).

Respondent argued before the Board that the Association actually was in a state of dissolution on March 27, and the meeting of that day had the effect of reconstituting it as the representative of only those employers who granted it full authority to speak for them. But this view cannot be reconciled with the Association's continuing representation of Association members without hiatus and without protest by the members both before and after March 27. In short, neither the Association nor its members, nor the formal arrangement between them, envisaged the structure of the Association as having the ephemeral nature attributed to it by respondent. Since the Association continued throughout the events in this case to speak for the entire bargaining unit, the only question presented by its exercise of representative authority is whether an individual member could impose private restrictions on the extent of such authority. As shown above, that question must be answered in the negative.

It may be added, moreover, that respondent's notion that a multi-employer bargaining relationship is

subject to dissolution at any point in negotiations by the independent actions of a small group of employers within the unit is contrary to the statutory principles of good faith bargaining in a multi-employer unit, as discussed above, pp. 17–22. There is no more reason for concluding that a small minority of employers in a multi-employer unit may destroy the stabilizing effect of group bargaining by signing separate agreements with a union than for concluding that they may do so by imposing private qualifications upon the authority of the representative. Cf. *Retail Associates, Inc.,* 120 NLRB 388, 393, n. 8. In either case, as we have shown, the procedure of group bargaining as contemplated by the Act requires the continuing existence of group authority to bind all employers within the bargaining unit.

In view of the foregoing, there is no need to consider whether there was any impropriety on the part of the Union and the Association members which executed separate agreements. Compare *Morand Bros.* v. *N.L.R.B.,* 190 F. 2d 576, 581 (C.A. 7), with *Elliot* v. *Sheet Metal Workers,* 42 LRRM 2100 (D.C., New Mex.). Whatever rights either the Association or its members may have *vis a vis* the Union and the employers which signed separate contracts, we have shown the multi-employer bargaining relationship continued in existence, and the Association continued to represent its members in negotiations with the Union. Since respondent did not effectively remove itself at any relevant time from the bargaining unit, it follows that it was bound, along with the other employers in the unit, by the results of the negotiations.

3. The Union did not acquiesce in respondent's refusal to be a party to the contract with the Association

Respondent's factual contention before the Board that the Union had indicated its agreement that the March 27 contract should not apply to respondent requires only brief consideration. The argument is based upon testimony to the effect that Union President Brandt, upon being informed on March 27 of respondent's position respecting the profit sharing proposal, acquiesced in respondent's attempt to remove itself from the coverage of any contract containing such a provision. As shown *supra,* p. 7, n. 6, the Trial Examiner, weighing this testimony against sharply differing accounts of Brandt's statements on March 27, concluded that "Brandt made no statement at this meeting reasonably construed as acquiescence in Jeffries' revocation of [Association] authority" (R. 22). Resolution by the Trial Examiner, whose findings were adopted by the Board, of this question of conflicting testimony may not be overturned on judicial review. See, e.g., *N.L.R.B.* v. *Radcliff,* 211 F. 2d 309, 315 (C.A. 9), certiorari denied, 348 U.S. 833; *N.L.R.B.* v. *West Coast Casket Co.,* 205 F. 2d 902, 906 (C.A. 9); *N.L.R.B.* v. *State Center Warehouse,* 193 F. 2d 156, 157 (C.A. 9).

Moreover, when Brandt talked with respondent's president on April 1, he indicated that the application of the contract to respondent was to be the subject of discussion with the Union's attorney before any final position was to be taken by the Union (*supra,* p. 7). And when the Union finally stated its position on the matter, it made explicit that it

considered respondent bound by the contract with the Association, and requested that respondent execute a copy thereof (*supra,* p. 8). In these circumstances, there is no basis for the contention that an understanding had been reached by respondent and the Union that respondent was not subject to the March 27 contract.

CONCLUSION

For the reasons stated, a decree should be entered enforcing in full the Board's order directed against respondent.

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APRIL, 1960.

APPENDIX

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 65 Stat. 601, 73 Stat. 519, 29 U.S.C., Secs. 151, *et seq.*), are as follows:

Rights of Employees

Sec. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, * * *

Unfair Labor Practices

Sec. 8. (a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

* * * * *

(5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 9(a).

* * * * *

(d) For the purposes of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder, and the execution of a written contract incorporating any agreement reached if re-

quested by either party, but such obligation does not compel either party to agree to a proposal or require the making of a concession: * * *

* * * * *

REPRESENTATIVES AND ELECTIONS

SEC. 9. * * *

(b) The Board shall decide in each case whether, in order to assure to employees the fullest freedom in exercising the rights guaranteed by this Act, the unit appropriate for the purposes of collective bargaining shall be the employer unit, craft unit, plant unit, or subdivision thereof:

* * * * *

PREVENTION OF UNFAIR LABOR PRACTICES

SEC. 10. * * *

(c) * * * If upon the preponderance of the testimony taken the Board shall be of the opinion that any person named in the complaint has engaged in or is engaging in any such unfair labor practice, then the Board shall state its findings of fact and shall issue and cause to be served on such person an order requiring such person to cease and desist from such unfair labor practice, and to take such affirmative action including reinstatement of employees with or without back pay, as will effectuate the policies of this Act: * * *

"(e) The Board shall have power to petition any court of appeals of the United States, or if all the courts of appeals to which application may be made are in vacation, any district court of the United States, within any circuit or district, respectively, wherein the unfair labor practice in question occurred or wherein such person resides or transacts business, for the enforcement of such order and for appropriate temporary relief or restraining order, and shall file in the court the record in

the proceedings, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition, the court shall cause notice thereof to be served upon such person, and thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to grant such temporary relief or restraining order as it deems just and proper, and to make and enter a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board. No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive. * * *''

U.S. GOVERNMENT PRINTING OFFICE: 1966

No. 16700

In the United States Court of Appeals for the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

JEFFRIES BANKNOTE COMPANY, RESPONDENT

ON PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

BRIEF FOR RESPONDENT

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BRIEF FOR JEFFRIES BANKNOTE COMPANY, RESPONDENT

STATEMENT OF THE CASE

Respondent was found to be in violation of Sections 8(a)(5) and 8(a)(1) because it refused to enter into a labor agreement which had been negotiated by a multi-employer group (Union Employers Section of Printing Industries Association [U.E.S.]) and the union.

Respondent's position is that it was not represented by U.E.S. at the time of the agreement with the union, in that it had effectively exercised its right to revoke its authorization to U.E.S. to negotiate for it. Finally, respondent states that the Board cannot and should not seek to compel it to execute a contract to which it has not agreed.

While the Board's statement of the evidentiary facts in the record is accurate in the main, there are several instances of

inaccuracy which require respondent to make this statement of the facts in the record.

I. The Facts In The Record

A. The Background Of The Bargaining:

In an earlier proceeding (R. 173–4, Res. Ex. 1), the Board had determined that the lithographic production employees of respondent constituted an appropriate bargaining unit. Consequent on that determination and certification, respondent negotiated its individual agreement with the union in 1956, for a term ending February 1, 1958. In the Fall of 1957, respondent and union joined in a series of collective bargaining meetings. No agreement resulted, the principal obstacles to agreement being the union security clause and a profit-sharing plan. This deadlocked situation between respondent and union continued to March 14, 1958 (R. 18).

Concurrent with its negotiations with respondent, the union negotiated as it had for many years past, with U.E.S., a multi-employer group comprised of a majority of the commercial lithographers in the area. While U.E.S. is an organization with a membership structure, it secured individual written authorizations from each member that it represented in collective bargaining (Bd. Brief, p. 3). Respondent was not a member of U.E.S. It never executed the formal authorization (R. 122).

Negotiations between U.E.S. and the union during this period did not result in agreement. As early as March 14, the multi-employer group, acting by its counsel, was compelled to warn the union against its bargaining with individual employers represented by U.E.S. (R. 162–3; G.C. Ex. 3).

On March 14, respondent designated U.E.S. as its bargaining representative. It accomplished this change of representation by a letter notifying the union of that designation (R. 17; 166; G.C. Ex. 4-B). Neither the union nor U.E.S. objected to this designation. Thereupon separate negotiations between respondent and the union were suspended.

Directly upon respondent's designation of U.E.S. as its bargaining agent, the union included for the first time in its negotiations with the group, a request for a profit-sharing plan (R. 18). The Trial Examiner comments (R. 18–19): "The substance of this proposal was that any employer having a profit-sharing plan covering factory employees would 'permit but not compel any member of the bargaining unit, who desires, to participate in the said plan.' It appears that there was then in effect at Jeffries a profit-sharing plan which the Union wanted open to the employees it represented."

Subsequent efforts to attain agreement between U.E.S. and the union were unsuccessful. The union called a strike against all employers represented by U.E.S. on March 20. The strike call was recognized by substantially all lithographic employees of companies represented by U.E.S. (R. 19).

B. The Union's Activities After The Inception Of The Strike, And The Events That Ensued.

While the strike was in progress, the union proceeded to negotiate individual agreements with at least seven companies that were then represented by U.E.S.[1] These individual negotiations were conducted clandestinely.

On March 26, the negotiating committee of U.E.S. met in emergency session at the call of its chairman, who explained that his company had negotiated individually with the union. He furnished each member of the committee with a copy of a memorandum containing the terms of settlement (R. 19–20; 136–138). He said that these terms represented the only basis of settlement for U.E.S.

The following morning, all employers represented by U.E.S. were invited to attend an emergency membership meeting.

[1]In his testimony, Brandt, the union president, lists seven companies as U.E.S.-represented employers with whom he negotiated during the strike period (R. 82–84).

Respondent was present at the meeting. The employers were told of the individual agreements. The terms of the secret settlement were revealed. The negotiating committee then advised the employers that continuation of the strike was futile, and recommended that U.E.S. accept the settlement negotiated by the union and the individual companies. This contained the profit-sharing proposal.

Before a vote was taken, the U.E.S. secretary announced that in view of the union's action in negotiating individual agreements, any employer who wished to revoke his authorization to U.E.S. could do so (R. 20, 140). Two of the members of U.E.S. signed revocation forms. Respondent, who was not a member of U.E.S., but was represented by U.E.S. under an informal designation, advised the committee that if the profit-sharing clause was to be part of the agreement, respondent "would not be a part of it," but that it would go along "on a contract which did not contain the profit-sharing clause which was in the memorandum." (R. 21; 140–141). The employers, by majority vote, decided to settle the strike on the union's terms.

The meeting between the U.E.S. bargaining committee and the union negotiators was held on the same day, tentative arrangements having been scheduled in advance for this meeting.

U.E.S. spokesmen advised the union of the position taken by respondent, and by another company which revoked its authorization. The statements made by U.E.S. spokesmen and Brandt, union president, present the only area of sharply disputed facts in the record[1]. Brandt testified that he was

[1]The Trial Examiner found that Brandt, union president, "made no statement at this meeting reasonably construed as acquiesence in Jeffries revocation of authority" (R. 22). We propose to review the record at this point, primarily not to controvert the Trial Examiner's finding, but to demonstrate that the union was advised unequivocally of respondent's revocation of authority. The union's response to this information is the best evidence of the clarity with which respondent's position was communicated.

advised by U.E.S. secretary that respondent "was not a party to the agreement if the profit-sharing clause was included" (R. 22; 100–101).

The most complete relating of the statement given to the union at this March 27 meeting appears in the testimony of employer representative, Laidlow, who advised the union as follows: (R. 150)

> "I told Mr. Brandt that he could have a contract with the Jeffries Banknote Company if he would remove the profit-sharing clause from his proposal, and he said that he would not do it, and I reiterated it, said, 'This is it; I am not kidding; this is what will take place. You can have a contract with the (195) profit-sharing clause out; you will have a contract with the Jeffries Banknote Company. With it in, you will not have a contract.' "

The testimony of various participants concerning Brandt's reply to this statement is in irreconcilable conflict. It ranges from testimony that Brandt was silent (R. 142) to testimony that the union considered respondent bound (R. 88), and finally testimony that Brandt replied, "We will just have to leave it so they will have to deal with us or we will deal with them." (R. 151).

After this discussion concerning respondent's revocation of authority was concluded, the meeting proceeded routinely. In an attempt to conceal the fact of its negotiations with individual employers, the union compelled the employers to propose as their offer, the terms of the settlement recently concluded between the union and one of the companies (R. 149–150). It contained the profit-sharing proposal which was directed solely at respondent.

The same day, the union accepted the "proposal." A master agreement was executed by the respective negotiating commit-

tees, and then identical contracts were executed by the individual employers.

C. *The Events Transpiring After U.E.S. And the Union Reached Agreement:*

Immediately upon membership ratification of the settlement, the union suggested to its members that they return to work. Respondent's employees did not return to work that day (Testimony of Brandt—R. 89).

On April 1, Brandt and Jeffries discussed the situation. Brandt testified that he was told "that [the union] did not have an agreement, but if the men wanted to come back to work without an agreement," the company would try to resume operations (R. 90). The men resumed work the following day.

With respect to the contractual situation, Brandt testified on cross-examination, that he was advised that now it was necessary for the company and the union to get together to negotiate an agreement, to which he replied that the situation was complicated, and he wanted to consult the union's attorney (R. 24; 91). Jeffries' testimony on this issue is to the effect that Brandt said that he realized there was no agreement between union and respondent and he hoped that they could amicably negotiate one, but that as the situation was complicated, he would like to consult counsel first (R. 120).

Following this meeting, respondent wrote to the union on April 1 (R. 170; G. C. Ex. 9) and the union replied on April 3 (R. 172; G. C. Ex. 10). Respondent's letter proposes to increase its employees by the same amount as the U.E.S. settlement, pending bargaining on an agreement covering its employees. The union's reply is reproduced verbatim in the Board's brief (Brief, p. 8). The union president expresses the thought that he is puzzled by respondent's wish to start negotiations, and states

that respondent advised the union that Printing Industries Association was bargaining for it[1].

Respondent refused to sign the U.E.S. contract. This proceeding followed.

SUMMARY OF THE ARGUMENT

In essence, what the Board seeks to accomplish in this proceeding is to compel respondent to sign an agreement to the terms of which it has never agreed. There is no dispute of the statement that *in fact*, respondent never agreed to the agreement which is the basis of this proceeding. Requiring either party to sign a labor agreement before it has agreed to the terms thereof, is offensive to public policy and public morals and violates the party's rights under the Fifth Amendment.

Respondent effectively and unequivocally revoked its bargaining authorization to U.E.S. before negotiations were resumed after the strike. Even absent the unusual circumstances occasioned by union violation of the Act, respondent had the right to revoke its designation of U.E.S. as its bargaining representative. This was a designation made one week before the union called a strike of its supporters. There can be no question of appropriate unit. The Board had previously certified that respondent's lithographic employees constituted an appropriate unit.

Insofar as it relates to respondent, the Board's authority to legislate "ground rules" as it did in Retail Associates Inc. 120 N.L.R.B. 388, without statutory warrant or support, is challenged.

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[1]By his own testimony, Brandt was told on March 27 that respondent would not be bound by a U.E.S. agreement containing a profit-sharing clause. Morever, at this meeting with Jeffries two days prior to date of Union's letter, respondent's position was reaffirmed. It would appear that the union's letter of April 3 (R. 172) was intended as a statement for the record, without regard to events which had transpired.

Even under these disputed "ground rules", respondent had the right to terminate the agency relationship with U.E.S. These rules permit withdrawal from the multi-employer group under "unusual circumstances". That is the situation presented by the record. The union disregarding prior cautionings by U.E.S. counsel, successfully destroyed any semblance of unity, cohesion or order in the multi-employer group, by bargaining to an agreement with at least seven companies who were represented by U.E.S. The U.E.S. meeting with its principals, and the subsequent meeting with the union committee, were the last steps in the organized chaos successfully generated by the union.

Under any concept of agency relationship, the principal had a right to terminate the relationship, when a substantial number of employers similarly situated, covertly met with the union, thereby repudiating their respective designations of U.E.S.

It is not sufficient to castigate the union's action as the Trial Examiner did as being "flagrantly violative" of the Act. The union should not be allowed to reap a windfall advantage out of its own derelictions. It abuses all concepts of stability in industrial relations to reward a union which has unstabilized an industry.

Respondent effectively exercised its right to revoke its designation of U.E.S. It advised U.E.S. that it would not accept a U.E.S. negotiated agreement if it contained the profit-sharing proposal, and conversely that it would accept the agreement if it did not contain a profit-sharing proposal.

There can be no question about the fact that its position was stated plainly to the union negotiators. The union president's reported indignation is the best evidence that the statement of position was unequivocal.

Despite the manner in which respondent's position was couched, it was unconditional in tenor. There was no element

of *probability* or *conjecture* which would make the withdrawal uncertain or conditional. With rigid precision, the union was told that respondent would not be bound by a U.E.S. contract with a profit-sharing clause. The union insisted on the clause. Respondent's position was absolute and firm.

The union's violation of its statutory obligation to bargain goes to the core of the present situation.

An employer should not be held in violation of his duty to bargain where the union creates the situation by its bad-faith bargaining.

Finally, it is pointed out that this is a refusal to bargain proceeding under 8(a)(5). The Board made no finding of bad faith, or absence of good faith. It made no inquiry in that regard. It elected to make a *per se* determination, on the assumption that this case fell within the purview of *H. J. Heinz Co. v. N.L.R.B.*, 311 U.S. 514. It does not, for the reason that complete agreement as to terms of the new contract was never attained.

ARGUMENT

I. The Board seeks to enforce an order compelling respondent to sign a contract to which it has never agreed, in violation of its rights guaranteed under the Fifth Amendment to the Constitution of the United States.

The remedial order for which enforcement is here sought is unique in Board history in that it seeks to compel an employer to sign a labor contract to which in fact it has never agreed. Early in the history of judicial review of the Act, the Supreme Court noted that the statutory scheme for labor peace excluded any element of compulsion to agree on an agreement. Indeed, were that element present in the Act, it would run counter to rights protected under the Constitution. In *N.L.R.B. v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 45, the Court said:

> "The theory of the Act is that free opportunity for negotiation with accredited representatives of employees is likely

to promote industrial peace and may bring about the adjustments and agreements which the Act in itself does not attempt to compel."

The privilege of contract is both a liberty and a property right (*Highland v. Russell Car & Snow Plow Co.*, 279 U.S. 253) protected by the Constitution. In the statutory definition of good-faith bargaining, Section 8(d), Congress carefully limited its definition so as to avoid any abuse of that protected privilege.

In no prior case has the Board attempted to compel a party to sign a labor agreement unless he had previously agreed to all of its terms. In *Heinz v. N.L.R.B.*, 311 U.S. 514, the employer was required to sign a contract after he had agreed to the terms thereof. In *N.L.R.B. v. Shannon & Simpson Casket Co.*, (C.A. 9) 208 F. 2d 545, the employer refused to acquiesce in agreements on specific clauses negotiated by his representative acting within the scope of his apparent authority. This Court enforced the Board's order requiring the employer to bargain collectively. No action was taken or attempted with respect to the negotiated agreements repudiated by the employer. In *N.L.R.B. v. Nesen*, (C.A. 9), 211 F. 2d 559, this Court was confronted with a situation generally paralleling the *Shannon & Simpson Casket Co.* In *Nesen* (which came before the Court on a petition to adjudge the employer in civil contempt) the employer, after cloaking his representative with plenary powers to negotiate, attempted to avoid the results of his negotiation by saying that the agent's powers did not extend to the power to negotiate. This Court held that the employer had agreed to the terms of the agreement, and thereupon entered an order requiring him to execute the agreement.

The Board also cites (Brief, p. 13) *N.L.R.B. v. Gittlin Bag Co.*, 196 F. 2d 158, in support of its position. This citation is of dubious relevance here. In that case, the employer flagrantly refused to accept a complete agreement negotiated over a period of a year-and-one-half by his attorney who had plenary

bargaining authority. The Board's order requiring him to bargain in good faith was enforced. The agreement which he repudiated, was not the subject of any order. In no instance has the Board ever compelled a party to sign a contract unless he had previously agreed to all terms in collective bargaining.

The Board decision in *McAnary & Walter, Inc.*, 115 N.L.R.B. 1029, is relevant here. There, the employer had participated in multi-employer bargaining. *After* the agreement had been completely negotiated by the union and the multi-employer group (to the extent that the secretary of the employer had signed the agreement), the employer attempted to repudiate it and to negotiate a new agreement. The Board, by a three-to-two decision, held that the withdrawal came too late.

In each of these cases, the bargaining proceeded conventionally to a negotiated conclusion without incident. In each instance, the employer attempted to repudiate the work of his designated representative *after* agreement had been attained. In contrast, the record in the case at bar discloses that the multi-employer negotiations did not proceed conventionally. In fact, the union's covert negotiations with individual employers all but destroyed any semblance of orderly negotiations. Again in contrast to the facts in the cited cases, respondent openly notified the union *before* agreement was reached that the multi-employer group no longer possessed plenary powers to represent it. Specifically, the group no longer had authority to bind it to an agreement containing a profit-sharing provision. There was no element of secrecy concerning respondent's withdrawal of authority from U.E.S. The union was well aware of the fact that U.E.S. no longer spoke for respondent, *before* the union resumed negotiations with the weakened multi-employer group.

In other cases, the Board has carefully avoided the issuance of a remedial order which would require an employer to sign a contract to which he had not in fact agreed. Thus in *Stylecraft Furniture Co.*, 111 N.L.R.B. 930, the employer was found

guilty of a refusal to bargain because of his insistence that at least one of his employees sign the contract. The Board said that a broad order requiring him to enter into a contract was not justified since there was not agreement on all subjects. More recently, in *North Carolina Furniture, Inc.*, 121 N.L.R.B. No. 8, the Board rejected the Trial Examiner's broad order requiring the employer to offer to execute an agreement containing all agreed-upon provisions. The Board did not adopt the recommended order because the parties had not reached complete agreement on all the terms of the agreement.

That respondent never agreed in fact to the contract which the Board here seeks to compel it to sign, is not open to question. Whether as a matter of law, it can be said that respondent constructively accepted the new agreement negotiated by U.E.S. is a proposition that we shall consider later in this brief.

To conclude this point of our argument, we submit that the Board's attempt to force respondent to sign an agreement it had never in fact accepted, deprives it of its rights, privileges and property contrary to the Fifth Amendment of the Constitution, and is contrary to the statutory scheme for labor peace.

II. Respondent had unequivocally withdrawn from the multi-employer group before the group resumed negotiations with the union. Respondent was not bound by negotiations between the group and the union subsequent to its withdrawal. The union's bad faith bargaining gave respondent additional warrant for its action.

A. *Respondent Had The Right To Withdraw Authority From The Multi-Employer Group To Bargain On Its Behalf:*

The Board, relying on its statement in *Retail Associates*, 120 N.L.R.B. 388, contends that respondent had no right to withdraw authority from the multi-employer group after the commencement of negotiations.

For this position, it assigns no statutory authority. The Board is saying in legal effect that having once designated U.E.S. as its bargaining representative, respondent forfeited its right to change representatives until negotiations were concluded. Such a drastic delimitation of respondent's rights cannot prevail in the absence of specific statutory authority.

No limitation exists on the right of the individual employer to substitute bargaining representatives in the course of negotiations; nor is there any inhibition on the union's right to designate other bargaining agents during the course of negotiations. The Board can cite no statutory support for its discriminatory treatment of employers who may have designated an association as their bargaining agent.

Granted that the Supreme Court, in *N.L.R.B. v. Truck Drivers Local 449*, 353 U.S. 85, 95–6 concluded that Congress intended

> "that the Board should continue its established administrative practice of certifying multi-employer units and intended to leave to the Board's specialized judgment the inevitable questions concerning multi-employer bargaining bound to arise in the future,"

this expression of confidence in the Board cannot serve as a delegation of legislative power to an administrative agency. There can be little question that this limitation on an employer's right to make changes in his bargaining representatives constitutes a deprivation of his rights which cannot stand without statutory authority.

The statutory origin of the Board's asserted authority to inhibit the employer's right to change bargaining representatives is §9(b) which charges the Board with the responsibility of determining the appropriate unit for collective bargaining. There is a vast body of prior administrative decisions in which the Board was called on to decide whether a single employer or a multi-employer group was the appropriate unit. Not the least significant of these appropriate unit cases is *Retail Associates*,

120 N.L.R.B. 388, where the Board attempted to set down the rules governing withdrawal from group bargaining.

We seriously question whether the designation of U.E.S. by respondent and the subsequent withdrawal of that designation involves an issue of "appropriate unit." The circumstances of this designation and subsequent withdrawal indicate that U.E.S. was merely a bargaining agent for respondent, similar to the designation of an attorney or labor relations specialist. Respondent was not a member of the group. As a matter of record, the Board had previously determined that the lithographic employees of respondent constituted an appropriate unit (R. 18). For five months in the current negotiations, its own officers were its bargaining representatives. Then for a period of thirteen days, U.E.S. was made its bargaining agent by a specific letter of designation (R. 17). To describe the arrangement between U.E.S. and respondent as one involving an appropriate unit question obfuscates a relatively simple matter of agency. The only connection between respondent and the multi-employer was the letter of authorization to act as its bargaining agent given in the closing days of negotiations. Why this designation should be treated as irretrievable and unalterable, thereby depriving the principal (the employer) of his right to terminate the authority of his agent (the multi-employer group) poses a question which cannot be answered by statute or legal precedent.

For its determination that respondent, having once designated U.E.S. as its bargaining agent, was powerless to modify that designation, the Board relies not on statute, but on its own "ground rules" promulgated as a side comment in *Retail Associates*, 120 N.L.R.B. 388, 393. These "ground rules" amounted not to a resolution of interests which the Act left for the Board on a case-by-case adjudication, but to a movement into a new area of regulation which Congress had not committed to it. The attempted promulgation of ground rules constitutes a classic

example of legislation by administrative agency. It cannot be employed to justify a ruling which deprives employers of their freedom in choice of representatives. This proclamation of policy cannot be justified as an administrative determination coming within the scope of the agency's rule-making authority, in the absence of specific statutory support. This Court in *Commissioner* v. *Van Horst*, (C.A. 9) 56 F. 2d 677,9, refused to recognize a particular regulation of the Commissioner of Internal Revenue. It said,

> "It is well settled that departmental regulation may not invade the field of legislation, but must be confined within the limits of congressional enactment."

The plain fact is that respondent's designation of U.E.S. as its bargaining representative created a relationship of principal-and-agent, which was revocable at any time by either party. In the absence of any other legal consideration giving rise to an interest which rendered the agency relationship irrevocable, the principal (respondent) had the right to terminate the agency relationship at any time[1]. This respondent did by its unequivocal, unconditional statement that U.E.S. had no authority to bind it to a labor agreement containing the disputed profit-sharing provisions.

B. *Even Under The Special Ground Rules Promulgated By The Board, Respondent Had The Right To Withdraw Its Authorization From The Multi-Employer Group:*

The Board's ground rules do not establish an absolute bar against an employer's withdrawal from a multi-employer group after the onset of negotiations. The Board recognizes that

[1]The Trial Examiner recognized that the common law rules of agency formed the foundation of the relationship between respondent and U.E.S. (R. 33). He acknowledges that there was an implied condition that the entire course of bargaining was to be conducted exclusively on a multi-employer basis, and that the union's violation of the condition made the designation by respondent revocable. The Board was apparently hostile to this idea.

under "unusual circumstances," an employer may withdraw from the group.

It would be difficult to conjure up a set of facts more unusual than those which confronted respondent on March 27. Only two weeks earlier, after five months of individual bargaining, it had designated U.E.S. as its bargaining agent.

The main issue between respondent and the union was a proposed profit-sharing provision which had economic significance only for respondent. Immediately after respondent had given U.E.S. its authorization, the union countered by adding the profit-sharing proposal to its bargaining demands to the multi-employer group. (The Board piously emphasizes the *standardization* of contract terms as the central feature of group bargaining (Brief, p. 19). The fact is that the union seeks to maneuver respondent into a position where it alone of all employers would be subject to the economic consequences of the profit-sharing provision).

The union, in open violation of its statutory duty [Sec. 8(b)(3)] to bargain with U.E.S., commenced to undermine the group by bargaining with individual employers (R. 19–20). This action the Trial Examiner characterizes as "flagrantly violative" of its statutory obligations (R. 38). As a consequence, the bargaining strength of the group which had just received respondent's bargaining authority, was sharply diminished.

At the emergency meeting of March 27, the employers who had previously designated the U.E.S. Committee to bargain for them, were informed that seven of their number, including two of the most substantial companies, had entered into individual agreements with the union. The spine of the multi-employer group had been broken. What alternatives did the employers have? The Trial Examiner, in his first assumption, says that U.E.S. might have declared that multi-employer bargaining was at an end. This is a sympathetic but not precise definition of the situation. The multi-employer group of 46

companies no longer existed. The union, by its open violation of Section 8(b)(3), and the seven defecting employers, by their repudiation of their written authorization to U.E.S., had jointly destroyed the former unit. (*Gladding, McBean & Co.*, 96 N.L.R.B. 823, is a helpful but not completely analogous situation).

The compelling logic of this statement, supplies the most persuasive precedent. Respondent might well decide to cast its lot with a cohesive group of 45 other printers, and yet might hesitate or refuse to ally itself with a group of 39 companies, when seven others, including two of the most substantial, were outside the group.

The situation should not be confused with that of *Retail Associates, Inc.*, 120 N.L.R.B, 388, where the remaining employers elected to remain in a multi-employer group. In that situation, it was appropriate for the Board to say:

> "Contrary to the union's contention in its brief, the resignation of Tredtke's from the Associates and its signing of a separate contract with the union did not, *in the circumstances here*, destroy the association-wide bargaining pattern—Withdrawal of one member of an association has never been held sufficient to preclude a determination of a unit of the remaining employers to be appropriate particularly when, as here, such withdrawal is acquiesced in by all parties, including the union." (Emphasis supplied.)

The Board in Retail Associates, was not called upon to express its policy opinion on the appropriateness of the unit, in a situation where the employer had elected to proceed individually. Absent only a situation where the changes in group composition may be disregarded as *de minimis* (Furniture Employers Council, 96 N.L.R.B. 151), the withdrawal of certain parties from the group undertaking, by the union's illegal acts, brought the former group to an end.

Under any concept of multi-employer bargaining, the situation created by the union's illegal acts, presented "unusual cir-

cumstances" sufficient to warrant a withdrawal by respondent from his recently delegated representative. The fact that 36 out of the remaining employers (7 out of the original group of 46 had succumbed to the union's individual bargaining) elected to remain in the group, does not reflect on respondent's right to resume individual bargaining. *Foundry Manufacturer Negotiating Committee, et al*, 98 N.L.R.B. 187, presents an interesting analogy. This was a representation proceeding. Several employers had withdrawn from the group. The survivors "reconstituted" themselves as a group. While the Board had occasion to say

> "Likewise, the withdrawal of members from employer associations, does not *per se* preclude a determination that a multi-employer unit comprising the remaining members is appropriate."

it was not called upon to pass on the question of what unit would be appropriate if the remaining members, or some one or more of them, elected to treat multi-employer bargaining at an end.

It is submitted that under the unusual circumstances created by the union on or before March 27, respondent had the right to revoke its authorization.

C. *Respondent Effectively And Unequivocally Withdrew Its Authorization on March 27.*

The keystone of Trial Examiner's order against respondent is his conclusion that respondent's withdrawal of its authorization to U.E.S. was ineffective because it was equivocal and conditional (R. 35). The Board adopted this view (R. 38).

The Trial Examiner characterized the withdrawal as conditional. "If the contract agreed upon suited him, he would consider himself bound; if it did not, he would consider himself not bound." (R. 35). This is not the record.

Respondent flatly told the U.E.S. negotiators that they had no authority to negotiate a contract for it which contained the profit-sharing clause. When the U.E.S. spokesman announced the position of respondent to the union, his auditors understood the plain meaning of his words. In effect, he announced that if the union persisted in its announced stand to secure in the industry contract, a profit-sharing clause which applied only to Jeffries, then respondent would not be a party to the contract. If, on the other hand, the profit-sharing clause was withdrawn, then Jeffries would be bound by multi-employer bargaining.

The Trial Examiner said that to be effective, a revocation of bargaining authority must be *absolute* (R. 35). Respondent's revocation became absolute by the decision of the union to persist in its demand for the profit-sharing clause. Once the union announced that it would not modify its position on the profit-sharing issue, it was then clearly, unequivocally and unconditionally understood by all participants that respondent had withdrawn its bargaining authorization.

The Board stresses its conclusion that respondent's revocation of authority to U.E.S. was not unequivocal. Solely to eliminate any unwarranted inference which might be drawn from this baseless emphasis, we note the judicial definition of "unequivocal" as "capable of being understood in only one way." (*Berry v. Maywood Mut. Water Co. No. 1*, 11 Cal.App 2d 479, 53 P. 2d 1032).

It is respectfully submitted that respondent effectively withdrew from the multi-employer group by its statement to the other employers, and that the employers' statement to the union was sufficient, in law and in fact, to put the union on notice that respondent was no longer bound by these negotiations.

The record, fairly construed, establishes that the union acquiesced in respondent's withdrawal from group bargaining.

Moreover, we contend that when the union proceeded to negotiate in the face of the unit question presented by respondent's withdrawal, it waived any right that it might have on that issue, and that now, by reason of its waiver, it must bargain collectively with respondent on an individual basis.

The Trial Examiner found it unnecessary to analyze the testimony bearing on the union's reply to the announcement that Jeffries had withdrawn from the multi-employer unit. He is content to say "I have found that nothing Brandt said at the meeting of March 27 when informed of Jeffries' conditional revocation of U.E.S. authority, can properly be construed as constituting a waiver by the union of Jeffries' continuing obligations as a constituent of the multi-employer unit." (R. 36).

The record is to the contrary. It bespeaks of the union spokesman's indignation, anger and then resignation at the fact that he would have to deal individually with respondent again. Out of the conflicting versions of the discussion which followed the announcement, the testimony of Laidlaw, temporary spokesman for the U.E.S. committee, appears to convey most accurately, the ensuing discussion. On direct examination, he testified:

> "Q: Did Mr. Brandt at that meeting make the specific statement that an agreement reached between your Negotiating Committee and the Union would be applicable to the Jeffries Company?
>
> A: I don't recall anything like that, because he said something to the effect that he would deal with them, something like that, or they would have to deal with him, 'They will answer for that,' something along those lines." (R. 153).

There is no convincing suggestion in the record that the union ever challenged the right of Jeffries to withdraw from the group. There is a similar absence of any inference that the union representatives failed to understand that the chairman's

announcement meant that respondent had withdrawn from the group. The union spokesman knew that the disorganization of the group had resulted from the union's illegal and yet successful divisive tactics. His attitude conveyed a warning of retaliatory measures which the union would invoke against respondent.

D. *A Refusal To Bargain Order Will Not Be Enforced Against An Employer In A Situation Where The Union Has Previously Been Guilty of Refusing to Bargain In Good Faith:*

The Trial Examiner was emphatic in his denunciation of the bad-faith bargaining of the union in negotiating secretly with individual members of the employer group (R. 38). Nonetheless, he concluded that the union's improper course of action did not provide legal justification for respondent's refusal to be bound by the group contract (R. 31).

It must be noted that the union's bad-faith bargaining was not collateral, unrelated and independent of the series of events occurring on March 26–27 which culminated in respondent's withdrawal of its authorization. Here the union's bad-faith bargaining was the catalytic act which set the stage for respondent's acts which followed.

In *Superior Engraving Co. v. N.L.R.B.* (C.A. 7), 183 F. 2d 783, the Court said:

> "Petitioner has persistently contended that an employer cannot be guilty of a refusal to bargain if the union is not itself bargaining in good faith. This is correct."

This principle of law is peculiarly apposite here where the connection between the union's bad-faith bargaining and the acts of respondent charged to be violative of 8(a)(5) are direct, proximate and almost causal. By an extension of the equitable maxim of "unclean hands," it is appropriate to insist that the union not be permitted to reap the advantages of the Board's

order in a situation where the union appears in the record as the instrumentality which destroyed good-faith bargaining.

Unlike the Trial Examiner, the Board viewed the union's misconduct cavalierly. In support of its position, it relies on *Masters, Mates, and Pilots* (J. W. Banta Towing Co.) 116 N.L.R.B. 1787, set aside on other grounds in 258 F. 2d 66, in which the Board held the "clean hands" doctrine inapplicable. The case at bar is clearly distinguishable in that here the employer's alleged lack-of-good-faith emanates causally from the forces set in motion by the union's improper conduct. In the case cited by the Board, the charging party's alleged misconduct did not induce or precipitate the violations attributed to the responding party.

This is a proceeding where the Board should have followed the philosophy of its decision in *Times Publishing Company*, 72 N.L.R.B. 676, where the Board refused to hold the employer in violation of his statutory duty to bargain because the union created a situation in which "it would do injustice and not effectuate the policies of the Act" to find the employer guilty of bad-faith bargaining. The union in the case at bar should not be allowed to profit by its illegal course of conduct.

III. The Board did not conduct an inquiry to determine whether respondent bargained in good faith. Instead, it rested its order exclusively on its finding that respondent had breached its ground rules applicable to multi-employer bargaining.

The Board held that respondent failed to bargain collectively in good faith as required by Section 8(a)(5). That section provides that it shall be an unfair labor practice for an employer to refuse to bargain collectively with the representatives of his employees subject to the provisions of Section 9(a). Neither the Trial Examiner nor the Board made any finding respecting the conduct or state of mind of employer during the negotiations (R. 14–38).

The Courts have uniformly held that to support an 8(a)(5) charge the attitude of the employer in bargaining must be found to be antagonistic to agreement. In the present case the employer earnestly sought to attain an agreement. However, agreement on a contract was never achieved, solely because the union persisted in its demand for a profit-sharing provision in the agreement. All other issues were resolved in collective bargaining.

The record is singularly devoid of any evidence that the Board inquired into respondent's state-of-mind as it approached the bargaining table. Beyond question, the Board proceeded on the convenient assumption that respondent's withdrawal from the multi-employer bargaining group was *per se* sufficient to support a finding of violation of Section 8(a)(5). That assumption is contrary to law. There is no simple short-cut for the inquiry required under that section.

The issue before the Board was whether respondent met its statutory duty to bargain collectively in good faith. A principle firmly established by the Courts, but often avoided by the Board, is that the inquiry must always be whether or not under the total circumstances of the particular case, the employer has bargained in good faith.

In its determination of the employer's state of mind, i.e., whether he engaged in bargaining with the sincere desire to reach agreement with the union, the Board may draw inferences from the negotiator's external conduct, as well as from his declarations. Yet in each instance where the Board succeeded in securing enforcement of its order that an employer was guilty of a lack-of-good-faith in bargaining, it was the employer's bad faith in bargaining and not his specific external conduct that sustained the order. Thus, in *H. J. Heinz Co. v. N.L.R.B.*, 311 U.S. 514, 526, the employer's refusal to put his agreement in writing was the manifestation that the employer's state of mind was hostile to agreement with the union. But it was the

employer's hostile state of mind, and *not* the refusal to sign an agreement, that justified the finding of refusal to bargain.

Obviously, the Board's burden would be substantially eased if it could establish a list of specific acts, the commission of any of which would *per se* constitute a violation of the duty-to-bargain-in-good-faith. As a matter of administrative convenience, the development of such a list of specific acts, the commission of any of which constituted *per se*, a violation of 8(a)(5), may seem attractive to those charged with the burden of making a finding as to an employer's state-of-mind. Fortunately, the Board cannot rely on any *per se* determination, but must make an inquiry into the employer's good faith, or the absence thereof, in collective bargaining. Thus, in *N.L.R.B. v. American National Insurance Co.*, 343 U.S. 395, 404, the Court rejected the Board's offer to support its order under Section 8(a)(5) by urging

> "a theory quite apart from the test of good faith bargaining prescribed in Section 8 (d) of the Act, a theory that respondent's bargaining for a management function clause as a counter-proposal to the union's demand for unlimited arbitration, was 'per se' a violation of the Act."

Again, in *N.L.R.B. v. Truitt Mfg. Co.*, 351 U.S. 149, 154, the Court cautioned the Board that its enforcement of a Board order under 8(a)(5) involving a refusal to disclose financial information, did not mean that the Board was warranted in adopting a mechanical approach to its statutory obligation in administering that section, by noting:

> "We do not hold, however, that in every case in which economic inability is raised as an argument against increased wages, it *automatically* follows that the employees are entitled to substantiating evidence. Each case must turn on its particular facts. The inquiry must always be whether or not under the circumstances of the particular case the statutory obligation to bargain has been met." (Emphasis supplied.)

Most recently, in *N.L.R.B. v. Insurance Agents*, 361 U.S. 477, the Court rejected a Board's finding that a union was guilty of a refusal to bargain, where the finding was supported solely by proof of the union's commission of certain harassing, unprotected tactics, and where the finding was not supported by any consideration of the union's good faith in conferring with the employer. Holding that the Board's approach involves an invasion into the substantive aspects of the bargaining process, the Court said (361 U.S. 477, 490):

> "The scope of Section 8(b)(3) and the limitations on Board power which were the design of Section 8(d) are exceeded, we hold, by inferring a lack of good faith not from any deficiencies of the union's performance at the bargaining table by reason of its attempted use of economic pressure, but solely and simply because tactics designed to exert economic pressure were employed during the course of the good-faith negotiations. Thus the Board in the guise of determining good or bad faith in negotiations could regulate what economic weapons a party might summon to its aid. And if the Board could regulate the choice of economic weapons that may be used as part of collective bargaining, it would be in a position to exercise considerable influence upon the substantive terms on which the parties contract."

Of particular relevance is the comment of Mr. Justice Frankfurter in his separate opinion (361 U.S. 477, 501, 503–4) where he said:

> "The Board urges that this Court has approved its enforcement of Section 8(b)(3) by the outlawry of conduct per se, and without regard to ascertainment of a state of mind. It relies upon four cases: H. J. Heinz Co. v. Labor Board, 311 U.S. 514; Labor Board v. Crompton-Highland Mills, 337 U.S. 317; Labor Board v. F. W. Woolworth Co., 352 U.S. 938; and Labor Board v. Borg-Warner Corp., 356 U.S. 342. These cases do not sustain its position."

An analogous situation was presented to this Court in *Lloyd A. Fry Roofing Co.*, (C.A.9) 216 F. 2d 273, 276 where the Board

had based its order of refusal to bargain on the employer's failure to invest his bargaining representative with sufficient authority. Rejecting the Board's petition for enforcement, this Court said:

> "However the lack of authority which the bargaining representative possesses in negotiating a labor agreement should not be held to be *per se* a violation of 8(a)(5)."

The deficiency in the record before the Court is clearly demonstrated by a comparison of the instant record with the statement made by the Board in *Southern Saddlery Co.*, 90 N.L.R.B. 1205, where the Board described its function under Section 8(a)(5):

> "Bargaining in good faith is a duty on both sides to enter into discussions with an open and fair mind and a sincere purpose to find a basis of agreement touching wages and hours and conditions of labor. In applying this definition of good faith bargaining to any situation, *the Board examines the Respondent's conduct as a whole* for a clear indication as to whether the latter has refused to bargain in good faith *and the Board usually does not rely upon any one factor as conclusive evidence that the Respondent did not genuinely try to reach an agreement.*" (Emphasis supplied)

In the case at bar, the Board's decision contains not a trace of any attempt to evaluate respondent's conduct at the bargaining table (R. 47–49). Neither did the Trial Examiner whose concluding findings (R. 25–38) were accepted by the Board with modifications, inquire into respondent's state-of-mind at the bargaining table. It is apparent that the Trial Examiner felt that he was bound by the Board's ground rules as enunciated (without statutory warrant) in *Retail Associates*, 120 N.L.R.B. 388.

No consideration was given to respondent's conduct during the bargaining period between the Fall of 1957 and March 14, 1958 (R. 18),—a period during which respondent bargained on a single employer basis; nor to the confusion and uncertainty

prevailing at the U.E.S. meeting of March 27, 1958 (R. 20; 136–141); nor to the fact that respondent, alone among the employers, would be affected by the union proposal on profit-sharing (R. 18–19); nor to the fact that the entire situation was precipitated by the union's bad faith in bargaining with individual members of the multi-employer group.

The Board in its brief (p. 13), urges Section 8(d) in support of its position. That section requires "the execution of a written contract, incorporating any agreement reached if requested by either party." The requirement of executing a written agreement is binding only after the parties have agreed. The vital issue here is whether respondent and union did in fact agree on the terms of a new agreement. Until the parties reached an accord on the inclusion or exclusion of the profit-sharing proposal, neither party could compel the other to sign an agreement. The union negotiators were repeatedly advised at their last meeting with the U.E.S. group that respondent did not agree to their profit-sharing proposal.

This Court is now urged by the Board to enforce its order compelling respondent to execute a contract to which it never agreed. Granting solely for the sake of full discussion that under certain circumstances the Board has the statutory authority to do so, we earnestly submit that in the case at bar, the absence of a factually-supported finding of bad-faith-bargaining creates a legal and moral bar to enforcement.

CONCLUSION

For the reasons stated, the petition for enforcement should be denied and the proceeding dismissed.

JOHN H. DOESBURG, JR.

J. NORMAN GODDESS
Attorneys for Respondent.

May, 1960.

No. 16700

United States
Court of Appeals
for the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

vs.

JEFFRIES BANKNOTE COMPANY,
Respondent.

Transcript of Record

Petition For Enforcement of an Order of The National Labor Relations Board

Phillips & Van Orden Co., Fourth and Berry Sts., San Francisco, Calif.—3-9-60

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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GENERAL COUNSEL'S EXHIBIT No. 1-H

United States of America
National Labor Relations Board

CHARGE AGAINST EMPLOYER

* * * * *

Case No. 21-CA-3028. Date Filed 4-11-58. Compliance Status Checked By: E.F.

1. Employer Against Whom Charge Is Brought:

Name of Employer: Jeffries Banknote Company.

Address of Establishment: 117 Winston Street, Los Angeles 13, California.

Number of Workers Employed: 200.

Type of Establishment: Factory.

Identify principal product or service: Printing.

The above-named employer has engaged in and is engaging in unfair labor practices within the meaning of section 8 (a), subsections (1) and (5) of the National Labor Relations Act, and these unfair labor practices are unfair labor practices affecting commerce within the meaning of the act.

2. Basis of the Charge:

Since on or about December 1, 1957, the above-named Employer, acting through his officers, agents, or employees, has refused to bargain collectively with the undersigned Labor Organization, the representative of his employees.

General Counsel's Exhibit No. 1-H—(Continued)

By these and other acts, said Employer, acting through his officers, agents or employees, has interfered with, restrained, or coerced employees in the exercise of the rights guaranteed in Section 7.

3. Full Name of Party Filing Charge: Amalgamated Lithographers of America, AFL-CIO.

4. Address: 1220 South Maple Avenue, Los Angeles 15, California. Telephone No.: RIchmond 7-7413.

5. Full Name of National or International Labor Organization of Which It Is an Affiliate or Constituent Unit: Amalgamated Lithographers of America.

6. Address of National or International, if any: New York City, N. Y.

7. Declaration:

I declare that I have read the above charge and that the statements therein are true to the best of my knowledge and belief.

April 11, 1958.

/s/ By TED BRANDT
President

Admitted in evidence August 11, 1958.

GENERAL COUNSEL'S EXHIBIT No. 1-J

United States of America
National Labor Relations Board

FIRST AMENDED CHARGE AGAINST EMPLOYER

* * * * *

Case No. 21-CA-3028. Date Filed: 6-18-58.

1. Employer Against Whom Charge Is Brought:

Name of Employer: Jeffries Banknote Company.

Address of Establishment: 117 Winston Street, Los Angeles 13, California.

Number of Workers Employed: 200.

Type of Establishment: Factory.

Identify principal product or service: Printing.

The above-named employer has engaged in and is engaging in unfair labor practices within the meaning of section 8 (a), subsections (1) and (5) of the National Labor Relations Act, and these unfair labor practices are unfair labor practices affecting commerce within the meaning of the act.

2. Basis of the Charge:

Since on or about December 1, 1957, the above-named Employer, acting through his officers, agents, or employees, has refused to bargain collectively with the undersigned labor organization, the representatives of his employees.

General Counsel's Exhibit No. 1-J—(Continued)

By these and other acts, said Employer, acting through his officers, agents or employees, has interfered with, restrained, or coerced employees in the exercise of the rights guaranteed in Section 7.

3. Full Name of Party Filing Charge: Amalgamated Lithographers of America, Local 22, AFL-CIO.

4. Address: 1220 South Maple Avenue, Los Angeles 15, California. Telephone No.: RIchmond 7-7413.

5. Full Name of National or International Labor Organization of Which It Is an Affiliate or Constituent Unit: Amalgamated Lithographers of America.

6. Address of National or International, if any: 143 West 51st Street, New York 19, New York.

7. Declaration:

I declare that I have read the above charge and that the statements therein are true to the best of my knowledge and belief.

June 17, 1958.

/s/ By TED BRANDT
President

Admitted in evidence August 11, 1958.

GENERAL COUNSEL'S EXHIBIT No. 1-L

United States of America
Before The National Labor Relations Board

Twenty-First Region

Case No. 21-CA-3028

JEFFRIES BANKNOTE COMPANY,

and

AMALGAMATED LITHOGRAPHERS OF AMERICA, LOCAL 22, AFL-CIO

COMPLAINT AND NOTICE OF HEARING

It having been charged by Amalgamated Lithographers of America, Local 22, AFL-CIO, herein called the Union, that Jeffries Banknote Company, herein called the Respondent, has been engaging in and is engaging in unfair labor practices affecting commerce as set forth and defined in the National Labor Relations Act, as amended, 61 Stat. 136, herein called the Act; the General Counsel of the National Labor Relations Board, on behalf of the Board, by the undersigned Regional Director, issues this Complaint and Notice of Hearing pursuant to Section 10 (b) of the Act and Section 102.15 of the Board's Rules and Regulations, Series 7:

1. The charge was filed by the Union on April 11, 1958, and was served on the Respondent on April

General Counsel's Exhibit No. 1-L—(Continued)

15, 1958. A first amended charge was filed on June 18, 1958, and was served on the Respondent on June 19, 1958.

2. The Respondent, a California corporation, is engaged in financial printing. During the 12-month period immediately preceding the issuance of this Complaint and Notice of Hearing, Respondent shipped products and furnished services valued in excess of $50,000 to points outside the State of California.

3. The Respondent, beginning about March 14, 1958, and at all times material herein was a member of Union Employers' Section Printing Industries Association, Inc., of Los Angeles, herein called the Association, an association of firms engaged in the printing business and associated in part for the purposes of collective bargaining. At all times material herein the Association has represented its members, including the Respondent, in collective bargaining with the Union and has negotiated collective bargaining agreements with the Union on behalf of its members. At all times material herein the Association was and is the duly authorized agent of its members, including the Respondent, for this purpose.

4. The members of the Association, during the most recent 12-month period, have sold products and furnished services valued in excess of $50,000 directly to points outside the State of California and also sold products and furnished services valued in excess of $100,000 to firms in California which, in

General Counsel's Exhibit No. 1-L—(Continued)

turn, shipped products valued in excess of $50,000 directly to points outside the State of California.

5. By reason of the facts set forth in paragraphs 2, 3 and 4 above, the Association and the Respondent, and each of them, are, and at all times material herein have been, engaged in commerce within the meaning of Section 2, subsection (6) of the Act.

6. The Union is a labor organization within the meaning of Section 2, subsection (5) of the Act.

7. All lithographic (direct or offset) production employees of all employer members of the Association, excluding all other employees, constitute a unit appropriate for purposes of collective bargaining within the meaning of the Act which assures to the employees the full benefit of the right to self-organization, and otherwise effectuates the policies of the Act.

8. At all times material herein the Union was and is the designated representative of a majority of the employees in the unit described in paragraph 7 above for the purposes of collective bargaining and is the exclusive bargaining representative of all the employees in the above-described unit for the purposes of collective bargaining with respect to rates of pay, wages, hours of employment and other conditions of employment.

9. On March 27, 1958, while bargaining negotiations were under way between the Association and the Union, the Respondent, without the consent of the Union, attempted to withdraw from the Association and to abandon the unit set out in paragraph

General Counsel's Exhibit No. 1-L—(Continued)

7 above, to which the Association and the Union had previously committed themselves.

10. The Respondent failed and refused to sign an agreement entered into on March 27, 1958, between the Union and the Association on behalf of its members, including the Respondent, and continues to fail and refuse to sign said agreement.

11. By the acts and conduct set forth in paragraphs 9 and 10 above, the Respondent engaged in and is engaging in unfair labor practices within the meaning of Section 8 (a), subsections (1) and (5) of the Act.

12. The activities of the Respondent, as set forth in paragraphs 9 and 10 hereof, occurring in connection with the operations of the Respondent and the Association as described in paragraphs 2 through 5 hereof, have a close, intimate and substantial relation to trade, traffic and commerce among the several states of the United States and have led and tend to lead to labor disputes burdening and obstructing commerce and the free flow of commerce as defined in Section 2, subsection (7) of the Act.

13. The acts and conduct of the Respondent, as set forth in paragraphs 9 and 10 above, constitute unfair labor practices affecting commerce within the meaning of Section 8 (a), subsections (1) and (5), and Section 2, subsections (6) and (7) of the Act.

Please Take Notice that on the 21st day of July, 1958, at 10:00 a.m., DST, in Hearing Room 1, on

General Counsel's Exhibit No. 1-L—(Continued)

the Mezzanine Floor, 849 South Broadway, Los Angeles, California, a hearing will be conducted before a duly designated trial examiner of the National Labor Relations Board on the allegations set forth in the above Complaint, at which time and place you will have the right to appear in person, or otherwise, and give testimony.

You are further notified that, pursuant to Sections 102.20 and 102.21 of the Board's Rules and Regulations, you shall file with the undersigned Regional Director, acting in this matter as agent of the National Labor Relations Board, an original and four (4) copies of an answer to said Complaint within ten (10) days from the service thereof and that unless you do so all of the allegations in the Complaint shall be deemed to be admitted to be true and may be so found by the Board.

Wherefore, the General Counsel of the National Labor Relations Board, on behalf of the Board, by the undersigned Regional Director, this 9th day of July 1958, issues this Complaint and Notice of Hearing against Respondent herein.

[Seal] /s/ RALPH E. KENNEDY,
Regional Director, National Labor Relations Board,
Twenty-First Region.

Admitted in Evidence August 11, 1958.

GENERAL COUNSEL'S EXHIBIT No. 1-O

[Title of Board and Cause No. 3028.]

ANSWER OF RESPONDENT

Now comes Jeffries Banknote Company, Respondent in the above entitled cause, by John H. Doesburg, Jr., its attorney, and files its Answer to the complaint in the above entitled cause as follows:

1. Respondent admits the allegations contained in paragraph 1 of complaint.

2. Respondent admits the allegations contained on paragraph 2 of complaint.

3. Respondent denies the allegations contained in paragraph 3 of complaint.

4. Respondent neither admits or denies the allegations contained in paragraph 4 of complaint, as it has no knowledge of same.

5. Respondent admits that it has been engaged in commerce within the meaning of Section 2, subsection (6) of the act but has no knowledge with respect to the association.

6. Respondent admits the allegations contained in paragraph 6 of complaint.

7. Respondent denies the allegations contained in paragraph 7 of complaint.

8. Respondent denies the allegations of paragraph 8 of complaint.

General Counsel's Exhibit No. 1-O—(Continued)

9. Respondent denies the allegations contained in paragraph 9 of complaint.

10. Respondent admits the allegations contained in paragraph 10 of complaint to the extent that respondent refused and presently refuses to sign an agreement entered into on March 27, 1958 but denies that such Association or group of employers were authorized to make such agreement on behalf of Respondent. Respondent also denies that the Association was at all times material herein, the authorized agent of Respondent.

11. Respondent denies the allegations contained in Paragraph 11 of complaint.

12. Respondent denies the allegations contained in Paragraph 12 of complaint.

13. Respondent denies the allegations contained in Paragraph 13 of complaint.

14. Respondent hereby denies any and all allegations contained in complaint not specifically herein affirmed or denied in this Answer.

/s/ JOHN H. DOESBURG, JR.,
Attorney for Respondent.

Duly Verified.

Admitted in evidence August 11, 1958.

United States of America

Before The National Labor Relations Board
Division of Trial Examiners

Branch Office
San Francisco, California

Case No. 21-CA-3027

ANDERSON LITHOGRAPH COMPANY, INC.

and

Case No. 21-CA-3028

JEFFRIES BANKNOTE COMPANY

and

AMALGAMATED LITHOGRAPHERS OF AMERICA, LOCAL 22, AFL-CIO

INTERMEDIATE REPORT AND RECOMMENDED ORDER

Statement of the Case

The consolidated complaint herein alleges, in substance, that Anderson Lithograph Company, Inc., hereinafter Anderson, and Jeffries Banknote Company, hereinafter Jeffries, respectively violated Section 8 (a) (1) and (5) of the National Labor Relations Act, as amended, 61 Stat. 136, hereinafter the Act, by attempting to withdraw from and abandon a multi-employer unit, alleged to be an appropriate

unit, to which they had previously committed themselves, and by failing and refusing to sign an agreement negotiated on the basis of the multi-employer unit by their duly authorized representative and Amalgamated Lithographers of America, Local 22, AFL-CIO, hereinafter the Union.

On due notice a hearing before the undersigned was held at Los Angeles, California, on August 11, 12, 1958. All parties were represented and participated in the hearing. The jurisdictional allegations of the complaint were either admitted in duly filed answers to the complaint, or stipulated during the course of the hearing; the allegations of unfair labor practices denied. After the evidence had been taken, the General Counsel argued his position orally upon the record. The Respondents and the Union filed briefs.[a]

Upon the entire record in the case and from my observation of the witnesses, I make the following:

Findings of Fact

I. The business of the Respondents

Anderson, a California corporation, is engaged in lithography work. Jeffries, also a California corporation, is engaged in financial printing. During the 12-month period immediately preceding the issuance of the complaint herein, each shipped prod-

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[a] It is hereby ordered that the transcript of this proceeding be corrected pursuant to a stipulation of the parties identified herein and now received in evidence as Trial Examiner's Exhibit No. 2.

ucts or furnished services valued in excess of $50,000, to points outside the State of California. On these agreed upon facts, jurisdiction is admitted and found.

II. The labor organization involved

Amalgamated Lithographers of America, Local 22, AFL-CIO, is a labor organization within the meaning of Section 2 (5) of the Act.

III. The unfair labor practices

A. The controlling facts

On March 27, 1958, the Union reached an agreement with the Union Employers' Section of the Printing Industries Association, hereinafter U.E.S., on a contract covering employees of the some forty-odd employers who had designated the U.E.S. their bargaining representative. Anderson and Jeffries, respectively, as well as two or three other employers not named as respondents in this proceeding, although they had previously authorized the U.E.S. to bargain on their behalf, refused to execute or to be bound by the contract agreed upon and executed by the negotiating committees of U.E.S. and the Union. It is because of that refusal that we are asked to find Anderson and Jeffries in violation of Section 8 (a) (1) and (5) of the Act.

Bargaining between the Union and the U.E.S. on an association wide basis had existed for a substantial period prior to 1958, and the contracts which were the end results of these negotiations

were executed, on behalf of the employers, by the negotiating committee of the U.E.S. and by the employers individually. Prior to entering into negotiations, the U.E.S. obtains authorizations from the various employers to act in their behalf, and the Union is supplied with a list of employers who have submitted authorizations. Preliminary to negotiations on the 1958 contract, the Union, as was its custom, sent notices to Fred Miller, U.E.S. secretary, and to the 46 individual employees who had authorized U.E.S. to bargain on their behalf, proposing negotiations on a new contract to succeed the one terminating in February, 1958. Pursuant to these notices, negotiations for a new contract between U.E.S. and the Union began in September, 1957, and continued through December, 1957, and January, 1958, during which period some items were agreed upon and others remained open. There were further meetings in February, but no final agreement on a contract was reached.[1] On March 14, the Union received from Jeffries this notice:

> Jeffries Banknote Company has designated the Union Employers Section of Printing Industries Association of Los Angeles as its collective bargaining representative and will henceforth be represented in any negotiations by them.

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[1] A detailed statement of proposals and counter proposals, agreements and disagreements during the course of bargaining, is needless, inasmuch as the allegations of the refusal to bargain are based on the refusal of Anderson and Jeffries to execute the contract negotiated by U.E.S. and the Union.

Prior to receiving this notice, contract negotiations between the Union and Jeffries had been on an individual employer basis. In 1956, on the Union's petition and pursuant to a Board conducted election, the Union had been certified as representative of Jeffries' employees in an appropriate unit, and a contract was executed between the parties October 25, 1956. The expiration date of the contract was February 1, 1958. In the fall of 1957, the Union served Jeffries individually with notices for negotiations on a new contract and met with Jeffries individually in January and February, 1958, but no agreement was reached. After the notice of March 14, 1958, advising the Union that Jeffries would thenceforth be represented by U.E.S., negotiations between the Union and Jeffries, individually, ceased. Anderson had had contractual relations with the Union for some four years prior to 1958, had been represented by U.E.S. throughout this period and beginning with the Union—U.E.S. negotiations of September, 1957, John Anderson, its president, met with union representatives as a member of the U.E.S. negotiating committee.

Upon receipt of the March 14 notice from Jeffries, the Union included for the first time in its contract proposals, a request for a profit-sharing plan. The substance of this proposal was that any employer having a profit-sharing plan covering factory employees would "permit but not compel any member of the bargaining unit, who desires, to participate in the said plan." It appears that there was then in effect at Jeffries a profit-sharing plan which

the Union wanted open to the employees it represented. Be this as it may, an impasse in bargaining developed after the submission of this proposal and on March 20 the Union called a strike against all employers represented by U.E.S. The strike appears to have been effective, the testimony being that substantially all employees represented by the Union in the multi-employer unit, engaged in the strike.

While the strike was in progress, the Union approached certain employers represented by U.E.S., with respect to reaching an agreement on contract terms, and did in fact reach an agreement on contract terms individually with several of these employers.

On March 13, Theodore Brandt, the Union's president and a member of the Union's negotiating committee, received a letter from U.E.S., by the latter's legal counsel, stating insofar as is here material:

> We have been advised that the Union is making individual solicitations of the employers so represented [by U.E.S.]. We hereby put you on notice that the Union Employers Section is the exclusive collective bargaining representative for each and all of the employers named and therefore you may not lawfully enter into any negotiation, contract, or understanding with the individual employers, but may only deal through the Union Employers Section.

Apparently, as indicated above, the Union chose to ignore this communication.

On March 26, Fred Miller, U.E.S. secretary, came into possession of a memorandum purporting to be

an agreement on contract terms between the Union and two of the most substantial members of U.E.S., including acceptance by these employers of the Union's profit sharing proposal. He called an emergency meeting of the U.E.S. negotiating committee for that evening, and at this meeting, Frank Miller of Western Lithographing Company, stated that Western and General Lithographing Company, respectively, had made separate agreements with the Union, that the terms of the agreement on disputed issues were contained in the memorandum then in Fred Miller's possession, and that this agreement represented the only basis upon which the strike could be settled. On the following morning a meeting of employers represented by U.E.S. was held, the facts of the separate agreements negotiated by the Union and individual employers explained to them, and the recommendation was made that it was inadvisable, in view of the defections in their own ranks, to continue the strike. Thereupon it was agreed that U.E.S. would adopt as its own contract proposal to the Union, the terms of the agreements already negotiated by the Union with certain employers who had authorized U.E.S. to represent them.

Prior to taking this action, the U.E.S. secretary stated that in view of the action taken by the Union in negotiating agreements with members individually, any employer member of U.E.S. who wished to revoke the authorization previously executed naming U.E.S. its bargaining representative, could do so. Thereupon, Culver Citizen News and Anderson,

respectively, indicated that they were revoking their U.E.S. authorization. Anderson, according to his testimony, indicated that he would not participate in any subsequent caucuses with U.E.S. nor participate further with respect to U.E.S. negotiations with the Union. Admittedly, however, without communicating to the Union his revocation of U.E.S. authorization, Anderson, who as previously stated was a member of the U.E.S. negotiating committee, attended the meeting between that committee and the Union which occurred beginning at noon of the same day, and at this meeting the Union accepted the U.E.S. proposal for a contract. His explanation was that when the Union was advised that Culver Citizen News had revoked its U.E.S. authorization, Brandt, the Union's chief negotiator "blew his top" whereupon he, Anderson, thought it was better for the progress of negotiations between U.E.S. and the Union to keep silent about his own revocation. He signed a written revocation on April 2.

After the meeting of employers represented by U.E.S. had concluded on the morning of March 27, Jeffries' representative at the meeting indicated that Jeffries would "go along" with a contract negotiated by U.E.S. provided it did not contain a profit-sharing clause, but that if such a clause was included in the contract Jeffries would not sign it. When the U.E.S. negotiating committee met with the Union on that same day, the Union was informed of the Culver Citizen News' revocation to which, according to credited testimony, Brandt replied that it made no difference inasmuch as this

employer employed only one person within the bargaining unit. Brandt's response on being advised of Jeffries' position, is in dispute. Brandt testified, in effect, that he stated that the Union would consider Jeffries bound by any contract agreed upon by U.E.S. and the Union. Anderson testified that Brandt made no statement to the effect that Jeffries would be covered by such an agreement. Fred Miller testified that Brandt said nothing with respect to Jeffries' revocation of U.E.S. authority. Henry Leamon, a member of the Union's committee, testified that he thought Brandt made the statement that if Jeffries wanted to back out of the agreement, then it would be taken up between Jeffries and the Union. Other testimony varied between these extremes. Upon the entire testimony I am convinced and find that Brandt made no statement at this meeting reasonably construed as acquiescence in Jeffries' revocation of U.E.S. authority. In any event, the Union's position in the matter was shortly to be defined unequivocally.

Admittedly, at no time during the meeting of the bargaining principals on March 27 when the terms of a contract were agreed upon, was the Union advised that Anderson had revoked its U.E.S. authorization, or that Anderson in the person of its president, John Anderson, was present at that meeting in any other capacity than as a member of the U.E.S. negotiating committee. At the conclusion of the meeting, Anderson, along with other members of the U.E.S. negotiating team, shook hands with the Union's representative.

The contract agreed upon at the March 27 meeting was, in due course, executed by the negotiating committees respectively of U.E.S., with the exception of Anderson who did not sign, and the Union. As was customary, the Union submitted identical copies of the master agreement thus executed to all employers who had designated U.E.S. their bargaining representative, and these employers, with the exception of four or five, including Anderson and Jeffries, executed the contracts individually.[2] The Union also submitted to the employers individually, according to customary procedure, union label agreements which any employer who executed a copy of the master contract could sign or refuse to sign, this being optional with the signatory employer.

Subsequent to the execution of the agreements the Union called Jeffries with respect to returning Jeffries' employees who had been on strike along with other employees of the multi-employer unit, to work. Jeffries advised Brandt that they would be returned to their jobs as work became available to them but under the terms of the contract which expired on February 1. He testified with respect to Brandt:

> He said he realized that there was no contract between Amalgamated and ourselves, but

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[2] Brandt testified that in addition to Anderson and Jeffries two U.E.S. members refused to sign the contract and that these employed only one employee each. The Union's attorney in his brief refers to five employers who did not execute the agreement.

> that he hoped that we could amicably negotiate one; but that the situation was rather complicated. He would like to talk to his attorney and he assumed that I would like to do so likewise.

Brandt's version of this conversation was that Jeffries agreed to return the men to work without an agreement if they wanted to return under those conditions, but suggested that they should negotiate an agreement, to which Brandt replied that he would have to talk to an attorney. He further denied that he in any way acquiesced in excluding Jeffries from the U.E.S. contract and testified that he informed Jeffries that the latter was bound by the contract. When Jeffries took issue with him, they agreed to consult their respective attorneys.

By letter dated April 2, Jeffries suggested to Brandt that the new wage scale incorporated in the U.E.S. contract be put into effect by Jeffries "so as not to penalize" Jeffries' employees "pending negotiation of a new contract." By letter dated April 3, Brandt replied:

> This is in answer to your letter to me of April 2, 1958.
>
> We are, of course, expecting that the wage increases will be instituted in your plant as of February 15, 1958, in accordance with the negotiations just concluded.
>
> I am puzzled by your statement that you wish to start negotiations with Local #22.

During negotiations with the Printing Industries Association, on behalf of the Lithographic Employers in Los Angeles, you advised Local #22, in writing, that the Association was bargaining for you as well as on behalf of the various other employers.

Accordingly, we must proceed on the assumption that there is no need for further negotiations, and that we may expect from you a signed contract in accordance with the terms agreed upon in the general negotiations.

There appear to have been no further meetings between Jeffries and the Union.

B. The issues; concluding findings

This is not a case whose resolution is likely to arouse enthusiasm in disinterested quarters, for no matter what turn it ultimately takes the fundamentals of good faith bargaining, ideally considered, have been abused and this is the fault, to a degree, of both parties upon whom the obligation to bargain rested.

There can be no doubt and, accordingly, I find, substantially as alleged in the complaint, that all lithographic (direct or offset) production employees of all the employers who designated U.E.S. their bargaining representative, constituted an appropri-

ate unit.[3] That the Union represented a majority of such employees is not seriously challenged. Its majority status was demonstrated when substantially all employees in the said unit engaged in the strike which the Union initiated on March 20, 1958. Also, there were union shop conditions prevailing substantially throughout the multi-employer unit.

Obviously, the multi-employer unit, being appropriate, did not automatically lose its appropriateness because the Union and certain employers represented by U.E.S. engaged in negotiations violative of their obligation to bargain exclusively on the basis of the multi-employer unit. A unit is appropriate or not appropriate as a matter of law. That the Union in 1956 was certified as representative of Jeffries' employees in an appropriate unit, did not bar their inclusion in the multi-employer unit when Jeffries in 1958, with the consent of the Union, authorized U.E.S. to represent it in negotiations on a contract. The employees of each of the employer members of U.E.S. might, under appropriate circumstances, be deemed to constitute an appropriate unit, but when brought together in the multi-employer unit the obligation to bargain rested exclusively on the larger unit, for obviously there can-

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[3] No contention is made that the composition of the unit was inherently inappropriate, the contention being that the multi-employer unit was dissolved by conduct of the Union and thereafter employees of Anderson and Jeffries, respectively, in the same job categories, constituted individual appropriate units.

not exist concurrently two appropriate units composed in whole or in part of the same employees. Whether, as a matter of law, the multi-employer unit lost its appropriateness with respect to the inclusion therein of employees of Anderson and Jeffries, because of individual bargaining which occurred between the Union and certain members of U.E.S. during the period of the authorizations, will be considered presently.

Anderson and Jeffries, among others, having authorized U.E.S. to represent them in negotiations on a 1958 contract, surrendered their status and identity as individual bargaining principals. Thereafter, for the period of the authorization, any agreement reached between U.E.S. and the Union, was their agreement, and a contract executed by U.E.S. and the Union was their contract, and they are bound by it unless there are present here "unusual circumstances" such as the Board may reasonably be presumed to have had in mind in Retail Associates, Inc., 120 NLRB No. 66A, where it spelled out in detail the bargaining obligations of individual members of a multi-employer unit.

The Respondent argues, in substance, that because of the terms of the authorizations executed by members of the multi-employer unit, the member employers were not bound by agreements arrived at between the negotiating committees of U.E.S. and the Union, respectively, but that said agreements, with respect to member employers, were merely recommendations which the employers were free to accept or reject. In support of this argument, it

points to the lack of specific language in the authorizations binding members to execute agreements arrived at between U.E.S. and the Union; that language in the authorization which provides that the authorization may be revoked after the execution of a contract between U.E.S. and the Union; and the customary procedure whereby in addition to the master contract executed by the respective negotiating committees of the parties, each employer member of U.E.S. executed an identical contract.

The authorization form speaks of a "tentative agreement" which the U.E.S. is authorized to negotiate on behalf of its members, and continues:

> If the Association reaches such tentative agreement, it shall be referred to a meeting of those companies signing this authorization, and in the event a majority of said companies attending this meeting ratify its terms, the Association shall then execute a formal contract with the Union binding upon each company signing this authorization.

At the March 27 meeting of U.E.S. members, called by Miller, the U.E.S. secretary, the adoption of contract terms previously agreed upon by the Union and certain U.E.S. members individually, as the proposal of the U.E.S. itself for a contract, was recommended by the U.E.S. negotiating committee, discussed, voted upon, and ratified by a majority of those attending the meeting. While this may not have been a formal "ratification" of a "tentative agreement" within the strict wording of the authorizations, it was in effect just that, for the contract

proposal of the U.E.S. thus ratified, was in reality acceptance of Union terms, and agreement on a contract followed as a matter of course. Further, there was implied ratification when only two members attending the March 27 meeting indicated that they would revoke their U.E.S. authorizations rather than accept the terms for a contract now proposed by the U.E.S., and unequivocal ratification when all but 5 employers out of the some 46 represented by U.E.S., signed identical copies of the master contract executed by the negotiating committees of U.E.S. and the Union, respectively.

Clearly, there is nothing in the wording of the authorizations to support the contention advanced by the Respondents that agreements reached between the respective negotiating committees were merely recommendations which U.E.S. members were individually free to accept or reject; to the contrary, the clear intent is that such agreements when accepted by a majority of members were binding on all. This being the fact, the provision for the revocation of the bargaining authority after the execution of a contract, can only refer to negotiations on future or succeeding contracts, or contract renewals. Any other construction would be inconsistent with the provision making an agreement reached by U.E.S. and the Union binding on all U.E.S. members when ratified by a majority, and would make a potential farce of the entire course of bargaining on the basis of the multi-employer unit.

The fact that in addition to the master contract executed by the respective negotiating committees,

individual constituents of the multi-employer unit executed identical contracts, has little added significance unless this be considered a form of ratification within the meaning of the authorizations. Execution of a contract by the negotiating committee of U.E.S., under all applicable rules of agency was execution by U.E.S., and binding on all employers represented by U.E.S. in collective bargaining. However, the execution of individual contracts identical with the master contract is not unusual practice in multi-employer bargaining and may be considered confirmation of acceptance by the individual employer of the contract terms. As the General Counsel's representative remarked at the hearing, there are those men who choose to wear both belt and suspenders.

The fact that simultaneously with submission of the master contract to individual members of U.E.S., the Union submitted agreements for the use of union labels, does not affect the composition of the multi-employer unit as an appropriate unit, for these union label agreements were not the subject of collective bargaining apart from the negotiations on the master contract: they were made available by the Union to all employers who executed copies of the master contract, and, as previously stated, it was optional with the said employers whether or not they accepted them. Acceptance or rejection had no effect on the application of the master contract.

Coming now to the more difficult problem of the effect of the Union's course of individual bargain-

ing with employers represented by U.E.S., there is no denying that the Union violated its obligation to bargain exclusively with the duly constituted U.E.S. negotiating committee, though by coming to terms with individual employers it succeeded in breaking the impasse which brought about the March 20 strike and influenced the U.E.S. to capitulate in its opposition to the Union's proposed contract terms. The vice in the Union's action was not, it is emphasized, that it struck to break the bargaining impasse, but that it engaged in individual bargaining with employers represented by U.E.S. during a peried when its obligation in law was to bargain exclusively with U.E.S. on the basis of the multi-employer unit, at that time the appropriate unit. Such action is analogous to that of an employer who when faced with a strike, in derogation of his obligation to bargain exclusively with his employees' duly designated representative, seeks out individual employees and attempts to reach an agreement with them individually for ending the strike. Such action on the part of an employer has uniformly been held to constitute a refusal to bargain. The Union, however, is not the Respondent in this action, and what we must here determine is whether its conduct provided legal justification for the action taken by Anderson and Jeffries in refusing to be bound by the contract executed by the negotiating committees of U.E.S. and the Union, respectively. Certainly, the Union was not by its improper course of action released from its own continuing legal obligation to bargain with the

U.E.S. And while the U.E.S., in view of the Union's action in making individual contracts with some five of the constitutents of the multi-employer unit, might have chosen to regard bargaining on a multi-employer basis at an end, it chose instead to continue its negotiations with the Union, and the Union joined it in those negotiations and a contract was agreed upon. There was therefore at no time a mutual abandonment by the bargaining principals of negotiations on a multi-employer basis.

In order to reach the precise problem posed by the facts of this case, it is nevertheless assumed, but not found, that on being notified of the Union's course of individual bargaining with certain employer members of U.E.S., employers represented by U.E.S. who chose to do so might lawfully forthwith revoke the authorizations previously given U.E.S. to act as their bargaining representative. Such an assumption would not necessarily rest on strict rules of agency, though it might be argued persuasively that U.E.S. authorizations were obtained and given with the implied condition that the entire course of bargaining during the period of the authorizations was to be conducted exclusively on the basis of the multi-employer unit—there can be no doubt that such was the understanding—and that the breach of this obligation by individual members of the multi-employer group in connivance with the Union, defeated the purpose and implied conditions of the authorizations, whereupon the latter became revokable. A somewhat broader and more elastic basis for the assumption would be

that relied on by the Board in the Times Publishing Company case (72 NLRB 676), a decision which has never, to my knowledge been overruled or modified, wherein the Board found, in effect, that the Union, as one of the bargaining principals, created a situation in which "it would do injustice and not effectuate the policies of the Act to find a violation of Section 8 (5) of the Act" charged against the employer.

Having made the assumption that authorizations given U.E.S. became revokable when the Union and certain U.E.S. members bargained outside the multi-employer unit, we next examine the facts to determine whether Anderson and Jeffries effectively revoked their authorizations at any time prior to agreement on a contract between U.E.S. and the Union. If the answer be in the affirmative, we have to move from the assumption to a finding on its validity as a legal conclusion, but on the facts of this case I am convinced that the answer may not properly be given in the affirmative.

The revocation of an authorization such as we have here, to be effective must be timely and unequivocal and must, I think, be communicated to both parties of the bargaining compact. Anderson's revocation was timely but was not, I think, unequivocal, and was not communicated to the Union until after the contract had been agreed upon. Although Anderson's president duly informed U.E.S. that he was revoking its authority to represent Anderson further, he continued to sit, ostensibly at least, as a member of the U.E.S. negotiating committee in a meeting with the Union's committee

which directly followed the employer's meeting during which Anderson had announced his revocation, and it was at this meeting that the respective negotiating committees agreed on a contract. His testimony that he did not enter into the discussions that occurred between the negotiating committees on this occasion is accepted, but nevertheless his presence there ostensibly as a member of the U.E.S. negotiating committee was participation, and the Union, not having any information to the contrary, would reasonably assume that he was continuing as a member of the U.E.S. negotiating team. Anderson's explanation that he refrained from informing the Union of his revocation for fear of causing an uproar which might prejudice the consummation of an agreement between the Union and U.E.S., hardly explains why he was there at all if, in fact, he intended unequivocally to revoke his U.E.S. authorization. One is inclined to question whether his revocation was intended, at the time it was initially expressed, to be unconditional, or whether he might not have considered himself bound by the contract agreed upon by U.E.S. and the Union had it not contained a clause which he personally found objectionable. His presence at this meeting, ostensibly as a member of the U.E.S. negotiating committee, strongly suggests that he was playing it smart; i.e., if the contract suited him he would conveniently forget the revocation, if it didn't he would rely on it. But in any event, any bargaining principal is entitled to know with whom he is bargaining, for any change in the composition of a bargaining prin-

cipal may cause a change in bargaining demands by his opposite. So far as it knew and to all appearances, at the time it reached an agreement on a contract with U.E.S., the Union was bargaining with Anderson as a constituent of the multi-employer unit. After an agreement had been reached on the basis of the U.E.S. proposal and had, in effect, been ratified by a majority of U.E.S. members, it was too late for a revocation of U.E.S. bargaining authority to be effective.

With Jeffries the case is simpler, for at no time prior to the consummation of an agreement did Jeffries unequivocally revoke U.E.S. authority to represent him in negotiations with the Union. His revocation was conditional. If the contract agreed upon suited him, he would consider himself bound; if it did not, he would consider himself not bound. Obviously, a revocation of bargaining authority to be effective must be absolute for otherwise it is no revocation at all but an attempt to modify the terms and condition the applicability of the initial authorization. The fact that Jeffries did not sign the usual authorization form but merely advised U.E.S. in writing that he was designating the latter his bargaining representative, in no sense qualifies his status as a member of the multi-employer unit, for authorization to bargain for a contract, absent express qualifications in the authorization itself, carries with it the legal obligation to be bound by whatever agreement is reached by the bargaining principals. Were it otherwise bargaining on a

multi-employer basis could be nullified at the caprice of an individual constituent.

The further argument with respect to Jeffries, that the Union in effect acquiesced in Jeffries' revocation of U.E.S. authority and agreed to negotiate with Jeffries outside the multi-employer unit, I must reject. I have found that nothing Brandt said at the meeting of March 27 when informed of Jeffries' conditional revocation of U.E.S. authority, can properly be construed as constituting a waiver by the Union of Jeffries' continuing obligations as a constituent of the multi-employer unit. Nor do I think waiver or acquiescence can be read into the fact that the Union talked to Jeffries about returning Jeffries' striking employees to work, and agreed for them to return to work in the face of Jeffries' insistence that they return under the terms of the contract between the Union and Jeffries which expired on February 1, 1958. If Jeffries was in fact bound by the contract executed by U.E.S. and the Union, there was no further occasion for his employees to remain on strike, and the terms of the U.E.S. contract would apply to him as a matter of law. I think the most that can be made of conversations occurring between Jeffries and Brandt subsequent to March 27 and prior to April 3, is that Brandt wanted to make certain of the legality of the Union's position relative to holding Jeffries bound by the U.E.S. contract, before committing himself. The Union's position was made clear in the letter of April 3 addressed to Jeffries over Brandt's signature, and it is immaterial whether

the contents of the letter were composed by Brandt himself or dictated to him by the Union's attorney. The letter stated unequivocally the Union's position in rejecting further negotiations with Jeffries and in insisting that Jeffries was bound by the terms of the master contract executed by U.E.S. and the Union. The fact that the Union took no action when in 1951 Jeffries, though having authorized U.E.S. to bargain for him, refused to be bound by its agreement with the Union, can hardly be construed as a permanent waiver by the Union of its rights as a bargaining principal with respect to Jeffries.

Without in any way condoning the action of the Union in going outside the multi-employer unit to bargain with individual employers in order to achieve its contract objectives, or the action of those employer members in violating the terms of the authorizations they had given U.E.S. to represent them in negotiations with the Union, I must find on the facts of this case that neither Anderson nor Jeffries effectively revoked their U.E.S. authorizations at any time prior to agreement on a contract by the negotiating committees of the Union and U.E.S., and that their refusals, respectively, to recognize the said agreement as binding on them as constituents of the multi-employer unit, constituted a refusal to bargain within the meaning of Section 8 (a) (5) of the Act, and, derivatively, interference, restraint and coercion within the meaning of Section 8 (a) (1) of the Act. These findings and conclusions are not properly regarded as "favoring" or

"rewarding" the Union, itself guilty of conduct flagrantly violative of the obligations that rest alike on the bargaining principals in a multi-employer unit, but as insuring, in the public interest and to the extent that we are able to within the scope of the complaint which defines and limits this action, the continued stability and effectiveness of association wide bargaining.

IV. The effect of the unfair labor practices upon commerce

The activities of the Respondents, and each of them, set forth in Section III above, occurring in connection with the operations of the Respondents described in Section I above, have a close, intimate, and substantial relation to trade, traffic, and commerce among the several States, and tend to lead to labor disputes burdening and obstructing commerce and the free flow of commerce.

V. The remedy

It having been found that Anderson and Jeffries respectively refused to bargain with the Union by failing and refusing to be bound by and to execute the contract negotiated on their behalf by their duly authorized bargaining representative, it will be recommended that Anderson and Jeffries, respectively, execute the said contract and effectuate it according to its terms.

Upon the basis of the foregoing findings of fact, and upon the entire record, I make the following:

Conclusions of Law

1. Anderson and Jeffries are respectively engaged in commerce within the meaning of the Act and their respective operations meet the jurisdictional standards set by the Board.

2. The Union is a labor organization within the meaning of Section 2 (5) of the Act, and, within the meaning of Section 9 (a) of the Act, at all times material herein has been the exclusive representative for purposes of collective bargaining of all lithographic (direct or offset) production employees of all the employers, including Anderson and Jeffries, who designated U.E.S. their bargaining representative; the said employees constitute a unit appropriate for the purposes of collective bargaining within the meaning of Section 9 (b) of the Act.

3. By failing and refusing to execute and abide by the terms of the contract executed with the Union on their behalf by U.E.S., Anderson and Jeffries respectively have refused to bargain within the meaning of the Act, thereby engaging in unfair labor practices within the meaning of Section 8 (a) (1) and (5) of the Act.

4. The aforesaid unfair labor practices are unfair labor practices affecting commerce within the meaning of Section 2 (6) and (7) of the Act.

Recommendations

Upon the basis of the foregoing findings of fact and conclusions of law and upon the entire record in the case, it is recommended that Anderson and

Jeffries and each of them, their respective officers, agents, successors, and assigns, shall:

1. Cease and desist from:

(a) Refusing to execute and effectuate the terms of the contract negotiated with the Union on their behalf by the Union Employers' Section of the Printing Industries Association, Inc.

2. Take the following affirmative action designed to effectuate the policies of the Act:

(a) Forthwith sign the agreement dated April 2, 1958, negotiated with the Union on their behalf by their duly designated bargaining representative, the Union Employers' Section of the Printing Industries Association, Inc., and abide by and effectuate the terms of the said agreement;

(b) Post at their respective places of business copies of the notice attached hereto as Appendix. Copies of the notice, to be furnished by the Regional Director for the Twenty-first Region, shall, after being duly signed by Respondents' representatives, respectively, be posted by the Respondents immediately upon receipt thereof, and maintained by them for a period of sixty (60) days thereafter in conspicuous places, including all places where notices to employees are customarily posted. Reasonable steps shall be taken by the Respondents to insure that said notices are not altered, defaced, or covered by any other material;

(c) Notify, respectively, the Regional Director for the Twenty-first Region, in writing, within

twenty (20) days from the date of the service of this Intermediate Report and Recommended Order, what steps the Respondents have taken to comply therewith.

It is further recommended that, unless within twenty (20) days from the date of the service of this Intermediate Report and Recommended Order the Respondents notify said Regional Director that they will comply with the foregoing recommendations, the Board issue an order requiring the Respondents to take the aforesaid action.

Dated: 10/28/58.

/s/ WILLIAM E. SPENCER,
Trial Examiner.

APPENDIX

Notice to All Employees Pursuant to the Recommendations of a Trial Examiner of the National Labor Relations Board, and in order to effectuate the policies of the National Labor Relations Act, we hereby notify our employees that:

We Will forthwith execute and effectuate the agreement dated April 2, 1958, negotiated by our representative in collective bargaining, Union Employers' Section of the Printing Industries Association, Inc., and Amalgamated Lithographers of America, Local 22, AFL-CIO. The bargaining unit covered by this agreement is:

> All lithographic (direct or offset) production employees of all employers, including the under-

signed, who designated Union Employers' Section of the Printing Industries Association, Inc., their representative for purposes of collective bargaining.

.....
Employer

Dated .....

By .....
Employer's Representative, Title

This notice must remain posted for 60 days from the date hereof, and must not be altered, defaced, or covered by any other material.

[Title of Board and Cause Nos. 21-CA-3027 and 3028.]

EXCEPTIONS OF RESPONDENTS TO INTERMEDIATE REPORT AND RECOMMENDED ORDER

The exceptions of Jeffries Banknote Company, a California corporation (hereinafter sometimes referred to as Respondent) to the Intermediate Report and Recommended Order of the Trial Examiner, are as follows:

1. The Trial Examiner erred in concluding that at the meeting between the Association and the Union held on March 27, 1958, the Union did not acquiesce in respondent Jeffries' revocation of au-

thority to the Association to represent him in collective bargaining (I.R. 4, l. 61; I.R. 5, ls 1-3).

2. The Trial Examiner erred, as a matter of law, in holding that the multi-employer unit does not lose its appropriateness when the Union proceeded to bargain and execute agreements with individual members of the multi-employer group. (I.R. 6, ls 44-47.) He should have held that the Union's violation of its obligation to deal exclusively with the multi-employer group destroyed the appropriateness of the multi-employer unit, subject however, to the right of the members of the multi-employer group to reconstitute it, by affirmative action, as their bargaining agent, in which event, the appropriateness of the multi-employer unit would have been restored.

3. The Trial Examiner is in error in his statement that "there was therefore at no time a mutual abandonment by the bargaining principals of negotiations on a multi-employer basis" (I.R. 9, ls 9-10). The action of the Association first, in extending to its members, the right to withdraw from multi-employer bargaining, and second in advising the Union of the withdrawals, and the action of the Union, in recognizing these withdrawals, is evidence that both parties recognized that the multi-employer unit was abandoned, and then restored on a reduced basis.

4. The Trial Examiner erred in his finding that respondent Jeffries at no time prior to the consummation of an agreement, unequivocally revoked the

authority to the Association to represent him in negotiations with the Union (I.R. 10, ls 22-24).

5. The Trial Examiner erred in his assumption that respondent Jeffries had a "continuing obligation as a constituent of the multi-employer group" (I.R. 10, ls 46-47).

6. The Trial Examiner is in error in failing to credit fully the testimony of Jeffries concerning his conversations with Union president Brandt, during the course of which the Union representative recognized that respondent Jeffries was not bound by the newly constituted multi-employer group (I.R. 10, ls 47-62; Tr. 139).

7. The Trial Examiner erred in his conclusionary finding that respondent Jeffries did not effectively revoke his authorization to the Association at any time prior to agreement on a contract by the negotiating committees of the Union and the Association (I.R. 11, ls. 10-17).

8. The Trial Examiner erred in failing to make the following findings, among others:

(a) that when the Union violated its obligation to bargain only with the multi-employer unit, the constituent members of the unit were free to bargain individually with the Union, and the multi-employer could be restored or reinstated only by the affirmative act of the consenting members.

(b) that respondent Jeffries effectively revoked his authorization to the multi-employer unit.

(c) that the Union was advised of this revocation, that it agreed thereto, and that prior to April 3, 1958, it recognized its obligations to bargain individually with respondent Jeffries.

(d) that respondent Jeffries was not bound by the agreement made by the newly constituted multi-employer group, and that his refusal to recognize that agreement as binding, does not constitute a refusal to bargain.

The exceptions of respondent Anderson Lithograph Company, Inc. are as follows:

9. Respondent adopts as its exceptions, the following exceptions of respondent Jeffries: exceptions two (2) and three (3).

10. The Trial Examiner erred in his finding that respondent Anderson at no time prior to the consummation of an agreement, unequivocally revoked the authority to the Association to represent him in negotiations with the Union (I.R. 10, ls 22-24).

11. The Trial Examiner erred in his assumption that respondent Anderson had a "continuing obligation as a constituent of the multi-employer group" (I.R. 10, ls 46-47).

12. The Trial Examiner erred in his conclusionary finding that respondent Anderson did not effectively revoke his authorization to the Association at any time prior to agreement on a contract by the negotiating committees of the Union and the Association (I.R. 11, ls 10-17).

13. Both respondents except to those provisions of the Intermediate Report which find that they have been guilty of the refusal to bargain within the meaning of Section 8 (a) (5) of the Act, and of interference, restraint and coercion within the meaning of Section 8 (a) (1) of the Act.

14. Both respondents except to each and every provision of the Recommended Order.

15. Both respondents except to refusal of the Trial Examiner to recommend that the complaint be dismissed against each of them.

Respectfully submitted,

ANDERSON LITHOGRAPH
COMPANY, INC.

and

JEFFRIES BANKNOTE
COMPANY

/s/ By JOHN H. DOESBURG, JR.,

Attorney for Respondents.

United States of America
Before the National Labor Relations Board

Case No. 21-CA-3027

ANDERSON LITHOGRAPH COMPANY, INC.

and

Case No. 21-CA-3028

JEFFRIES BANKNOTE COMPANY

and

AMALGAMATED LITHOGRAPHERS OF AMERICA, LOCAL 22, AFL-CIO.

DECISION AND ORDER

On October 28, 1958, Trial Examiner William E. Spencer issued his Intermediate Report in the above-entitled proceeding, finding that Respondent Anderson and Respondent Jeffries had engaged in, and were engaging in, certain unfair labor practices and recommending that they cease and desist therefrom and take certain affirmative action, as set forth in the copy of the Intermediate Report attached hereto. Thereafter exceptions and briefs were filed jointly by both Respondents.

The Board has reviewed the rulings made by the Trial Examiner at the hearing, and finds that no prejudicial error was committed. The rulings are hereby affirmed. The Board has considered the In-

termediate Report, the exceptions and briefs, and the entire record in the case, and hereby adopts the findings, conclusions, and recommendations of the Trial Examiner with the following modification:

In finding that the Respondents violated Section 8 (a) (5) of the Act by refusing to sign the agreement negotiated by the U. E. S., we agree with the Trial Examiner that neither Respondent Anderson nor Respondent Jeffries unequivocally withdrew from the current multiemployer U. E. S. unit before agreement was reached with the Union on a new contract. The record shows and the Trial Examiner found that although the Union had improperly concluded separate individual agreements with some other employer-members of the U. E. S., and although Respondents knew of these individual agreements, Respondents nevertheless continued negotiating with the Union on a multiemployer basis instead of withdrawing unequivocally in favor of negotiating on a single-employer basis. In these circumstances, and despite Respondents' unwillingness to accept a clause approved by the U. E. S. majority and thus binding on all minority members as well, we find that neither Respondent had made a withdrawal from the current U. E. S. multiemployer unit. We further find that to permit an individual member-employer to qualify or reject an agreement made by the multiemployer group with which he was then affiliated would render the general and widely-recognized practice of multiemployer bargaining virtually valueless.

We are not called on in this case to decide whether, if either Respondent had withdrawn from the negotiations after the start of negotiations but as soon as it learned of the Union's misconduct and because of such misconduct, the circumstances would have been sufficiently unusual to permit such a withdrawal. Whether the Union on its part violated Section 8 (b) (3) by its misconduct in making separate individual agreements after having commenced negotiations on a multiemployer basis is not material in this proceeding.[1]

Order

Upon the entire record in these cases, and pursuant to Section 10 (c) of the National Labor Relations Act, as amended, the National Labor Relations Board hereby orders that Respondent Anderson Lithograph Company, Inc. and Respondent Jeffries Banknote Company, their officers, agents, successors, and assigns, shall:

1. Cease and desist from:

(a) Refusing to sign the agreement dated April 2, 1958, negotiated with the Union on their behalf by the Union Employers' Section of the Printing Industries Association, Inc.;

---

[1] See Masters, Mates, and Pilots (J. W. Banta Towing Co.), 116 NLRB 1787, set aside on other grounds in 258 F. 2d 66 (C. A. 7, 1958), where the employer's misconduct was held no defense to the Union's violation of the Act.

(b) In any like or related manner interfering with, restraining, or coercing their employees in the exercise of the right to self-organization, to form labor organizations, to join or assist Amalgamated Lithographers of America, Local 22, AFL-CIO, or any other labor organization, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, or to refrain from any or all such activities, except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in Section 8 (a) (3) of the Act.

2. Take the following affirmative action designed to effectuate the policies of the Act:

(a) Forthwith sign the said agreement;

(b) Post at their respective places of business copies of the notice attached hereto marked Appendix.[2] Copies of said notice, to be furnished by the Regional Director for the Twenty-first Region, after being duly signed by each Respondent, shall be posted by that Respondent immediately upon receipt thereof, and maintained for a period of sixty (60) consecutive days thereafter in conspicuous

[2] In the event that this Order is enforced by a decree of the United States Court of Appeals, this notice shall be amended by substituting for the words "Pursuant to a Decision and Order" the words "Pursuant to a Decree of the United States Court of Appeals, Enforcing an Order."

places, including all places where notices to employees are customarily posted. Reasonable steps shall be taken to insure that the posted copies of the said notice are not altered, defaced, or covered by any other material;

(c) Notify the Regional Director for the Twenty-first Region, in writing, within ten (10) days from the date of this Order, of the steps taken to comply herewith.

Dated, Washington, D. C., September 15, 1959.

BOYD LEEDOM, Chairman,
STEPHEN S. BEAN, Member,
JOHN H. FANNING, Member,

[Seal] National Labor Relations Board.

APPENDIX

Notice to All Employees: Pursuant to a Decision and Order of the National Labor Relations Board, and in order to effectuate the policies of the National Labor Relations Act, we hereby notify our employees that:

We Will forthwith sign the agreement dated April 2, 1958, negotiated by our representative in collective bargaining, Union Employers' Section of the Printing Industries Association, Inc., with Amalgamated Lithographers of America, Local 22, AFL-CIO.

. . . . . .

(Employer)

Dated.....

By .....
(Representative) (Title)

This notice must remain posted for 60 days from the date hereof, and must not be altered, defaced, or covered by any other material.

United States Court of Appeals
For the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

vs.

JEFFRIES BANKNOTE COMPANY,
Respondent.

CERTIFICATE OF THE NATIONAL LABOR RELATIONS BOARD

The National Labor Relations Board, by its Executive Secretary, duly authorized by Section 102.92, Rules and Regulations of the National Labor Relations Board—Series 7, hereby certifies that the documents annexed hereto constitute a full and accurate transcript of the entire record of a consolidated proceeding had before said Board and known upon its record as Case Nos. 21-CA-3027 and 21-CA-3028. Such transcript includes the pleadings and testimony and evidence upon which the order of the Board in said proceeding was entered, and includes also the findings and order of the Board.

Fully enumerated, said documents attached hereto are as follows:

1. Stenographic transcript of testimony taken before Trial Examiner William E. Spencer on August 11, 12, 1958, together with all exhibits introduced in evidence.

2. Copy of Trial Examiner William E. Spencer's Intermediate Report and Recommended Order dated October 28, 1958. (Annexed to Item 4, below.)

3. Respondents' exceptions to the Intermediate Report received December 2, 1958.

4. Copy of Decision and Order issued by the National Labor Relations Board on September 15, 1959, with Intermediate Report attached.

In Testimony Whereof, the Executive Secretary of the National Labor Relations Board, being thereunto duly authorized as aforesaid, has hereunto set his hand and affixed the seal of the National Labor Relations Board in the city of Washington, District of Columbia, this 11th day of January, 1960.

[Seal] /s/ FRANK M. KLEILER,
Frank M. Kleiler,
Executive Secretary, National
Labor Relations Board.

[Endorsed]: No. 16700. United States Court of Appeals for the Ninth Circuit. National Labor Relations Board, Petitioner, vs. Jeffries Banknote Company, Respondent. Transcript of Record. Petition for Enforcement of an Order of the National Labor Relations Board.

Filed: January 14, 1960.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals
For the Ninth Circuit

No. 16700

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

vs.

JEFFRIES BANKNOTE COMPANY,
Respondent.

PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

To the Honorable, the Judges of the United States Court of Appeals for the Ninth Circuit:

The National Labor Relations Board, pursuant to the National Labor Relations Act, as amended (61 Stat. 136, 29 U.S.C., Secs. 151, et seq., as amended

by 72 Stat. 945), hereinafter called the Act, respectfully petitions this Court for the enforcement of its Order against Respondent Jeffries Banknote Company, its officers, agents, successors, and assigns. The consolidated proceeding resulting in said Order is known upon the records of the Board as Case Nos. 21-CA-3027 and 21-CA-3028.

In support of this petition the Board respectfully shows:

(1) Respondent is engaged in business in the State of California, within this judicial circuit where the unfair labor practices occurred. This Court therefore has jurisdiction of this petition by virtue of Section 10 (e) of the National Labor Relations Act, as amended.

(2) Upon due proceedings had before the Board in said matter, the Board on September 15, 1959, duly stated its findings of fact and conclusions of law, and issued an Order directed to the Respondent Anderson Lithograph Company, Inc. and Respondent Jeffries Banknote Company, their officers, agents, successors, and assigns. On the same date, the Board's Decision and Order was served upon Respondents by sending copies thereof postpaid, bearing Government frank, by registered mail, to Counsel for Respondents.

(3) Thereafter, Anderson Lithograph Company, Inc., its officers, agents, successors, and assigns, named as Respondent in the aforesaid order complied with the provisions contained therein. The Board, accordingly, seeks a decree enforcing said order against only Respondent Jeffries Banknote

Company, its officers, agents, successors, and assigns, requiring it to comply therewith.

(4) Pursuant to Section 10 (e) of the National Labor Relations Act, as amended, the Board is certifying and filing with this Court a transcript of the entire record of the consolidated proceeding before the Board upon which the said Order was entered, which transcript includes the pleadings, testimony and evidence, findings of fact, conclusions of law, and the Order of the Board sought to be enforced.

Wherefore, the Board prays this Honorable Court that it cause notice of the filing of this petition and transcript to be served upon Respondent, and that this Court take jurisdiction of the proceeding and of the questions determined therein and make and enter upon the pleadings, testimony and evidence, and the proceeding set forth in the transcript and upon the Order made thereupon a decree enforcing those Sections of the Board's said order which relate specifically to respondent herein and requiring Respondent Jeffries Banknote Company, its officers, agents, successors, and assigns to comply therewith.

Dated at Washington, D. C., this 3rd day of December, 1959.

/s/ THOMAS J. McDERMOTT,
Thomas J. McDermott,
Associate General Counsel, National Labor Relations Board.

[Endorsed]: Filed December 7, 1959. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

ANSWER OF RESPONDENT

Now comes Jeffries Banknote Company, Respondent in the above entitled cause, by its attorney, John H. Doesburg, Jr., and answers the Petition for Enforcement of an Order of the National Labor Relations Board, as follows:

1. Respondent admits the allegations contained in Paragraph 1 of the Petition.

2. Respondent admits the allegations contained in Paragraph 2 of the Petition.

3. Respondent admits that Anderson Lithograph Company, Inc. complied with the provisions contained in the Board Order. Respondent denies that said Order should be enforced against Respondent Jeffries Banknote Company because said Order is not supported by substantial evidence in the record, contains error in findings of fact, and is contrary to the established law governing cases of this nature.

4. Respondent denies that said Order should be enforced, and respectfully requests this Court to dismiss the Petition for Enforcement.

JEFFRIES BANKNOTE
COMPANY,
/s/ By JOHN H. DOESBURG, JR.,
Attorney for Respondent.

[Endorsed]: Filed January 1, 1960. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

STATEMENT OF POINTS RELIED UPON BY THE BOARD

To the Honorable, the Judges of the United States Court of Appeals for the Ninth Circuit:

Comes now the National Labor Relations Board, Petitioner, and pursuant to Rule 17 (6) of the rules of this Court, files this statement of points upon which it intends to rely in the above-entitled proceeding, and this designation of parts of the record necessary for the consideration thereof:

I.

Statement of Points

1. The Board properly found that respondent violated Section 8 (a) (5) and (1) of the Act by refusing to execute with the union which represented its employees a collective bargaining contract negotiated on its behalf by respondent's bargaining agent. This finding rests upon the Board's primarily factual determinations next stated.

a. Substantial evidence supports the Board's finding that the Union Employers Section of Printing Industries Association, Inc., of Los Angeles, a multi-employer bargaining association, was authorized by respondent to reach binding agreements with the Union on its behalf.

b. Substantial evidence supports the Board's finding that the Association reached agreement with the Union upon all the terms of the contract which respondent refused to execute.

c. Substantial evidence supports the Board's finding that respondent did not withdraw from the Association prior to its agreement with the Union.

2. The Board properly rejected respondent's contention that the Association no longer had power to bind its members upon the conclusion of individual agreements between the Union and several Association members.

Dated this 11th day of January, 1960.

/s/ MARCEL MALLET-PREVOST,
Assistant General Counsel, National Labor Relations Board.

[Endorsed]: Filed January 14, 1960. Frank H. Schmid, Clerk.

Before the National Labor Relations Board
Twenty-First Region

In the Matter of:

Case No. 21-CA-3027

ANDERSON LITHOGRAPH COMPANY, INC.

and

Case No. 21-CA-3028

JEFFRIES BANKNOTE COMPANY

and

AMALGAMATED LITHOGRAPHERS OF AMERICA, LOCAL 22, AFL-CIO.

TRANSCRIPT OF PROCEEDINGS

Hearing Room 1, Mezzanine Floor, 849 South Broadway, Los Angeles, California. Monday, August 11, 1958.

Pursuant to notice, the above-entitled matter came on for hearing at 10:00 o'clock, a.m.

Before: William E. Spencer, Esq., Trial Examiner.

Appearances: Ben Grodksy, Esq. and Sherwin C. MacKenzie, Esq., 849 South Broadway, Los Angeles, California; both appearing on behalf of the General Counsel. John H. Doesburg, Jr., Esq., 110 South Dearborn Street, Chicago, Illinois, appearing on

behalf of Respondents, Anderson Lithograph Co., and Jeffries Banknote Company. Matthew Silverman, Esq., Robinson, Silverman & Pearce, 110 East 42nd Street, New York 17, N. Y., appearing on behalf Amalgamated Lithographers of America, Local 22, AFL-CIO, the Charging Party. [1]*

* * * * *

Mr. Doesburg: No objection to the exhibits.

Trial Examiner: There being no objection to the offering of exhibits, they are received as offered.

(The documents heretofore marked General Counsel's Exhibits Nos. 1-A through 1-Q, respectively, for identification, were received in evidence.) [8]

* * * * *

Mr. Grodsky: I have caused to be marked as General Counsel Exhibit 2, a form of authorization, and this was represented to me by the Secretary of the P.I.A. that this is the form of [11] authorization which was signed by Anderson Lithograph Company. I have shown it to Counsel and he agrees that this is in fact that type of authorization. It is a blank authorization which I now offer into evidence.

(Thereupon the document above referred to was marked General Counsel's Exhibit No. 2 for identification.)

Trial Examiner: I understand it is agreed to by the Respondent.

Mr. Doesburg: Yes.

---

* Page numbers appearing at top of page of original Reporter's Transcript of Record.

Trial Examiner: It is received.

(The document heretofore marked General Counsel's Exhibit No. 2 for identification, was received in evidence.)

[See pages 160-161.]

* * * * *

THEODORE BRANDT

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Grodsky): Are you the president of Local 22? A. Yes. [12]

* * * * *

Q. As the president, are you a member of the negotiating team of the Local when they meet and negotiate agreements? A. Yes.

* * * * *

Q. (By Mr. Grodsky): Would you tell us how you go about—let us be more specific, how you went about negotiating the agreement which is now in effect?

A. Well, we first sent out 60-day notices and 30-day notices.

Q. To whom did you send those notices?

A. To individual Employers and a copy to the Secretary of the U.E.S. of the P.I.A.

Q. Proceed.

(Testimony of Theodore Brandt.)

A. Oh. Then, we form a committee of our local negotiating committee. We advise the Employers and they have a committee.

Q. Now, when you say you advise the Employers, whom do you advise? Do you advise each and every Employer of the composition of your committee? [13]

A. We advise the Secretary of the P.I.A.

Q. Go ahead.

A. And then meetings are set up, and we start to negotiate.

Q. Now, you say meetings were set up and you start to negotiate. Did you make arrangements about meetings? A. Yes.

Q. With whom did you make those arrangements?

A. With Mr. Fred Miller of the P.I.A., who was the Secretary of P.I.A.

Q. Where did the meetings take place?

A. Some took place in my office and some took place in the P. I. A. Office.

Q. Who represented the various Employers in those meetings?

A. Mr. Bob Orchard of the Ray Burns Lithograph Company, Mr. Les Bennett of Mission Engraving Company, Mr. John Anderson of Anderson Litho, Mr. Douglas Laidlaw of L. A. Litho. One more, Frank Miller of Western and Fred Miller of Fred Miller, Secretary of P.I.A. [14]

* * * * *

(Testimony of Theodore Brandt.)

Trial Examiner: Excuse me.

Q. (By Mr. Grodsky): Did the P.I.A. indicate that they were [15] authorized to act on behalf of some Employers? A. Yes.

Q. And approximately how many Employers did they indicate that they were authorized to act on behalf of? A. 46.

* * * * *

Q. Did they indicate in that communication who would represent this group of Employers at the coming negotiation? A. Yes.

Q. Is that the group whom you have mentioned previously, the various names of the people whom you mentioned?

A. With one exception. There was a Mr. Wolf of Cal Litho Plate who later resigned.

Q. In other words, he was in addition to the group whom you have mentioned?

A. Yes. [16]

* * * * *

Mr. Grodsky: I will now offer into evidence General Counsel Exhibit 3.

Trial Examiner: Any objection?

Mr. Doesburg: No objection. [17]

Trial Examiner: Received.

(The document heretofore marked General Counsel's Exhibit No. 3 for identification, was received in evidence.)

[See pages 162-163.]

* * * * *

(Testimony of Theodore Brandt.)

Mr. Grodsky: I propose a stipulation that Latham & Watkins did in fact represent the Association at that time.

Mr. Doesburg: So stipulate.

Q. (By Mr. Grodsky): I now show you General Counsel 4-A and 4-B, and ask you whether you have seen those letters before? A. Yes.

(Thereupon the documents above referred to were marked General Counsel's Exhibits Nos. 4-A and 4-B, respectively, for identification.)

Q. (By Mr. Grodsky): Did they in fact, did you see them, did they arrive at your office on or shortly after the date that they bear?

A. After the date they bear.

Q. Very shortly thereafter, the next day or so?

A. Yes.

Mr. Grodsky: I will offer General Counsel Exhibits 4-A and B, into evidence.

Trial Examiner: Any objection?

Mr. Doesburg: No objection.

Trial Examiner: Received.

(The documents heretofore marked General Counsel's Exhibits Nos. 4-A and 4-B, respectively, were received into evidence.) [19]

[See pages 164-166.]

* * * * *

Q. (By Mr. Grodsky): Afer you received that communication of March 14th, did the Union make any change in its position with reference to the Association? A. Yes.

Q. What was that change?

(Testimony of Theodore Brandt.)

A. We included a request for a profit-sharing plan.

Q. Before that time you had not included such a request in your negotiations with the Association?

A. Yes.

Q. Was that profit-sharing plan subsequently incorporated into the agreement which was reached which is now in effect? A. Yes.

Q. Without going into great detail, that is Section 27 of your present agreement, is it not?

A. Yes.

Q. After the March 14th date, what action if any did the Union take with reference to its continued bargaining with the companies? [20]

A. We had—we had a strike.

Q. Approximately when did the strike take place? A. March 20th.

Q. How long did it last?

A. Seven days. [21]

* * * * *

Q. (By Mr. Grodsky): While the strike was going on, did you have a meeting with the Employers which resulted in an agreement being reached? A. Yes.

Q. What was the date of that negotiating meeting? A. March 27.

Q. Were you there among the group representing the union, is that correct? A. Yes.

Q. Who was there representing the Employers; was it the same group that you mentioned earlier?

A. Yes. [22]

* * * * *

(Testimony of Theodore Brandt.)

Q. Do you recall what the major topic of discussion was at the meeting or if there were several, do you recall what they were?

A. Profit-sharing plan was the major discussion, on the profit-sharing plan.

Q. Do you recall if any of the Employers made any comment, any of the Employer representatives made any comment concerning this profit-sharing plan?

A. Mr. Anderson asked me if I would continue that strike if we didn't get the profit-sharing plan included, and I said I would.

At that point he walked away muttering, saying that I was crazy.

Q. During this meeting was anything said by any Employer representative concerning the position which Jeffries was taking, Jeffries Banknote Company was taking with reference to this profit-sharing plan?

A. Mr. Miller in substance said that if this plan was included, if this clause was included, then Mr. Jeffries would not go along, would not sign the contract.

Q. When you say Mr. Miller, to whom are you referring? There are two Mr. Millers. [23]

A. Mr. Fred Miller, Secretary of the P. I. A.

Trial Examiner: You said that in a negotiating meeting?

The Witness: Yes.

(Testimony of Theodore Brandt.)

Q. (By Mr. Grodsky): Was there any individual representative from Jeffries Banknote Company at the negotiating session?

A. Not that I can remember.

Q. Did you at that meeting reach an agreement and conclude an agreement? A. Yes.

Q. How was that agreement memorialized at that time? A. By shaking hands all around.

Q. Did you observe whether Mr. Anderson participated in this?

A. He shook hands with members of the committee, all members of the committee, including myself.

Q. Now, at the time that you reached this agreement, was the strike still in effect? A. Yes.

Q. Was anything said at this meeting concerning the strike?

A. I advised the Employers that members were standing by at a meeting to which I would immediately go and make my report and recommend that this agreement be accepted, and the members would then report back to work immediately. [24]

* * * * *

Q. I show you General Counsel Exhibit 5 for identification, and ask you if you recognize that instrument? A. Yes.

(Thereupon the document above referred to was marked General Counsel's Exhibit No. 5 for identification.)

Q. (By Mr. Grodsky): Will you describe what that is?

(Testimony of Theodore Brandt.)

A. This is the agreement between the lithographers' group of Los Angeles and the Amalgamated Lithographers, Local 22, of America.

Q. Is the one that you have in front of you the signed one? A. Yes.

Q. Is that referred to as the master agreement?

A. Yes.

Q. And on behalf of the Employers under the words, "Employers' Committee," by whom is it signed?

A. By Les Bennett, by Frank A. Miller, Robert Orchard, Douglas Laidlaw and Fred Miller.

Q. Are those the members, the Employers Negotiating Committee, about whom you testified?

A. Yes. [25]

* * * * *

Q. Now, I ask you, in the 1956 to 1958 agreement, you did have an agreement for '56-'58, is that correct? A. Yes.

Q. Did that also have a union shop provision?

A. All but the Allerton H. Jeffries Company.

Q. That is the Jefferson Banknote Company?

A. Jeffries Banknote Company, yes.

Q. The Jeffries Banknote Company in 1956 to 1958 had an individual agreement with you, is that correct? A. Yes.

Q. That you had been certified as the representative of the employees in 1956, is that right?

Mr. Doesburg: Objection.

Mr. Grodsky: I will withdraw it.

(Testimony of Theodore Brandt.)

I will ask the Board to take official recognition——

Mr. Doesburg: I don't object to your asking the question. I want you to say "who." You didn't refer to who. You said certified.

Mr. Grodsky: I would like the Board to take official notice of its own proceeding in Case 21-RC-4362, which involved a proceeding of Jeffries Banknote Company and Local 22 as a result of which the Petitioner and the Charging Party here were [27] certified as the representative of the employees in the unit described in that proceeding.

Q. (By Mr. Grodsky): I don't know if I had an answer to this question, but in your 1956 to 1958 agreement——

Trial Examiner: With the Employer Association.

Q. (By Mr. Grodsky): Yes, with the various Employers, the agreement did in fact have the union shop provision? A. Yes.

Q. In the 1956-58 negotiations, you also had a master contract signed by the committee, similar to the contract which you had signed in '58?

A. Yes.

Q. In the past, what has been your practice? You have a master contract signed, such as we have in evidence, is that correct? A. Yes.

Q. And in addition to that, you have other contracts signed?

A. We get individual contracts from——

Q. From each of the Employers? A. Yes.

(Testimony of Theodore Brandt.)

Q. And in your current negotiations involving the 1958 to 1960 agreement, you had your master contract signed, is that correct? A. Yes.

Q. In addition to that, have you received individual [28] agreements? A. Yes.

Q. You received individual agreements from almost all the Employers, we will start there.

A. Yes.

Q. And from whom have you not received individual agreements?

A. From four Employers.

Q. And two of those, of the four, are Jeffries and Anderson, is that correct? A. Yes.

Q. Who are the other two?

A. Best Printing Company and Culver City Citizen, which employed one employee each.

Q. At the time when you entered negotiations with the Association, the Association furnished you with a list of the Employers whom they represented, is that correct? A. Yes. [29]

* * * * *

Trial Examiner: Any objection?

Mr. Doesburg: No objection.

Trial Examiner: Received.

(The document heretofore marked General Counsel's Exhibit No. 6 for identification, was received in evidence.)

[See pages 169-170.]

Q. (By Mr. Grodsky): Now, at sometime during the negotiations between yourself and the committee on behalf of the Association, do you recall

(Testimony of Theodore Brandt.)

whether any representative of the Employers on the Employers' side made a statement to the effect that they were at this time representing Jeffries?

A. Yes.

Q. Do you recall what meeting that was in, and who made the statement?

A. Mr. Fred Miller made the statement, and it was about March the 18th meeting.

Q. Was that the meeting at which the Union introduced the demand for a profit-sharing plan?

A. Yes.

Trial Examiner: Let's see, that was in 1958.

The Witness: 1958.

Q. (By Mr. Grodsky): Now, before the time when Jeffries was represented by the Association, did you negotiate with Jeffries in connection with a collective bargaining agreement? A. Yes.

Q. Did you have in existence an agreement with Jeffries before this time? A. Yes.

Mr. Doesburg: Objection. Before what time?

Q. (By Mr. Grodsky): Well, before 1958?

A. Yes.

Q. When did you start negotiating with Jeffries for another agreement, approximately?

Trial Examiner: I take it the agreement that expired prior to 1958 is what you are interested in.

Q. (By Mr. Grodsky): Well, when did the agreement that you had, when did it expire by its terms? A. February 1st, 1958.

Q. When did you start negotiating for another agreement, approximately?

(Testimony of Theodore Brandt.)

Mr. Doesburg: With whom?

Q. (By Mr. Grodsky): With Jeffries.

A. Approximately 30 days before.

Q. Did you meet once or more than once with Jeffries in connection with negotiations, that is, with representatives of Jeffries Banknote Company? A. More than once.

Q. Was there any particular point of difference which created the chief difference in receiving an agreement?

A. Yes. The Union security clause, Section II. Mr. Jeffries [38] said that if I could eliminate that, he would be willing to sign a 10-year contract.

Q. Did you also—let me ask you, have any other clause which you had difficulties with Mr. Jeffries?

A. Yes, the profit-sharing clause.

Q. And you continued to meet and negotiate with Jeffries as an individual concern until you——

Trial Examiner: Until when?

Q. (By Mr. Grodsky): Until when did you continue?

A. I continued to meet with Mr. Jeffries until I received the March 14th letter which advised me that the Association would now be representing him in negotiations.

Trial Examiner: What notification was it that you had?

The Witness: Dated March the 14th. I received two notifications.

Mr. Grodsky: Those are exhibits.

(Testimony of Theodore Brandt.)

The Witness: Dated March 14th.

Mr. Grodsky: 4-A and 4-B, these two. [39]

* * * * *

Q. Mr. Brandt, directing your attention to an earlier line of testimony, you indicated that at the last meeting Mr. Miller told you, that is, the meeting of March 27th, Mr. Miller told you that Jeffries Banknote Company would not go along with the agreement if it provided a profit-sharing plan. Do you recall that? A. Yes.

Q. Now, did you agree in any way to excluding that plan from the agreement?

Mr. Doesburg: Objection. That calls for a conclusion. He can testify as to what he said.

Q. (By Mr. Grodsky): Did you say anything or what did you say to the Employer representatives with reference to that?

A. I stated that the Jeffries Banknote Company was bound by the agreement that would be reached by the committees. [41]

* * * * *

Q. (By Mr. Grodsky): Mr. Brandt, you testified that after you had the master agreement signed, you also had individual agreements signed with all but four of the Employers. Do you recall that testimony? A. Yes.

Q. Now, were all the terms of the individual contracts identical with the terms of the master contract? A. Yes. [42]

* * * * *

(Testimony of Theodore Brandt.)

Cross Examination * * * * *

Q. (By Mr. Doesburg): Yes. The first one, ten years' ago when you first negotiated, how many Employers did that contract cover?

A. Approximately 30.

Q. Approximately 30. That has increased over the 8 bargaining periods to the present, which I think you said there were approximately 46 companies, is that correct? A. Yes. [44]

* * * * *

Q. Now, would you tell us what your procedure is at the termination of an agreement or prior to the negotiations of an agreement, how do you get into negotiations with the Employers?

A. Well, we send them a 60-day notice, a 30-day notice.

Q. Wait a minute. You send a 60-day notice, and to whom do you address the 60-day notice?

A. To the individual Employers and the one copy to the P.I.A., to its Secretary.

Q. So in this particular instance you would send out approximately 46 individual notices to 46 individual Employers, and 1 to the Secretary of the Union, Employers' Section of P.I.A., is that correct? A. Approximately, yes.

Q. What do these notices in essence say?

A. This is to advise you that this agreement—I can't recall.

Q. Just the essence of it. I don't want the exact words.

(Testimony of Theodore Brandt.)

A. That we are requesting a meeting, that the contract will terminate shortly, we would like the pleasure of getting together with you for the purposes of negotiating the changes in the contract.

Q. That goes out approximately 60 days prior to the termination of the date of the agreement?

A. Yes.

Q. Then approximately 30 days before, what did you do; what [45] is the 30 day?

A. A similar letter.

Q. It is a similar letter? A. Yes.

Q. Between the 60-day notice and the 30-day notice, you don't meet with anybody?

A. We do meet.

Q. You do meet. Whom do you meet with?

A. With the representatives of the Association.

Q. How do you get in touch with them after the 60-day notice; how is that meeting arranged?

A. Through the Secretary of the P.I.A.

Q. Do you call him or does he call you?

A. I called him and he calls me.

Q. Do you remember this year whether he called you or you called him?

A. We called each other a number of times.

Q. Prior to any meeting?

A. Prior to any meeting.

Q. Do you recall whether in 1958 you started negotiations earlier than usual? A. Yes.

Q. Will you tell us the circumstances under which you started negotiations earlier than usual and how it came about?

(Testimony of Theodore Brandt.)

A. We started negotiations on September the 17th. We [46] thought perhaps by starting earlier we could conclude earlier and therefore remove any tensions that had previously been had by negotiating right up to the very last minute. [47]

* * * * *

Q. In December. Now, we have a meeting in September, October and December, is that correct?

A. I am not sure. I haven't got the records with me.

Q. Then let me ask you this question. There was a third [49] meeting, however? A. Yes.

Q. And to the best of your knowledge that was prior to January 1, 1958?

A. We had two or three meetings before the end the year. I can't recall exactly. [50]

* * * * *

Q. Now, then, when was the next meeting held?

A. I would say during February.

Q. During February. What transpired at that meeting? A. Discussed the proposal.

Q. Were any agreements reached?

A. I can't recall. [51]

* * * * *

Q. What is the reference that you just testified to that you made in the negotiations in San Francisco?

A. Well, it was common practice that Local 22 usually waited until San Francisco culminated its negotiations. The contract expires in October, the

(Testimony of Theodore Brandt.)

21st, and normally Los Angeles follows San Francisco.

Nevertheless, we were ready and willing to end our negotiations if the Employers submitted a proposal which we considered, would consider satisfactory. [53]

* * * * *

Q. Now, returning to the first of March, when was the next meeting, if you can recall, that you had with the negotiating committee?

A. During February, we had——

Q. Following the first, following the 28th of February. A. In early March.

Q. In early March. What transpired at that meeting?

A. We came down somewhat in our demands and the Employers came up in their demands, in their proposal.

Q. Did anything else take place?

A. Outside of negotiations, I know of nothing.

Q. I mean, in the negotiations? You just stated that some proposals were changed? [54]

A. Yes.

Q. That is, that you compromised some of your demands, they compromised some of their demands; is that correct? A. Yes.

Q. Did you add any demands?

A. After being advised that the Jeffries Banknote Company was being represented by the Association, I changed my demand then to include a profit-sharing clause.

(Testimony of Theodore Brandt.)

Q. By including a profit-sharing clause, you mean including a clause which would require Employers to participate in a profit-sharing plan?

A. Employees to participate.

Q. You are not negotiating now with employees. You are negotiating with Employers. What did this profit-sharing plan that you refer to, what did it have to do with it?

A. That Employers, that if a plant, if a lithograph plant under contract to us had a profit-sharing plan, that members of Local 22 be entitled to participate or not participate as they so wish.

Q. That demand was never made upon the Employers or any Employer in Los Angeles, until Jeffries became a part of the negotiating group, is that correct? A. Yes.

Q. Then what happened? What was the next thing that happened after that meeting? [55]

A. It was concluded and we continued to negotiate on the overall package.

Q. You mean you included it in your demands?

A. Yes.

* * * * *

Q. Then, what was the next thing that happened? A. Local 22 went out on strike.

Q. On what day was that?

A. March 20th.

Q. What was the issue of the strike?

A. Over economics, over wages and the conditions that were requested.

(Testimony of Theodore Brandt.)

Q. In other words, it was a strike to utilize economic force to break an impasse in bargaining, is that correct? A. Yes.

Q. That was on what date?

A. March 20th.

Q. You went out on March 20th. What did you then do? [56]

* * * * *

Q. Did you or your Union, to your knowledge, approach and make an agreement with any individual lithographic firm, formerly a member of this group?

A. I did not approach. No, I did not approach.

Q. Did any member of your group make an agreement? A. Yes.

Q. During the strike? A. Yes.

Q. With whom did they make an agreement?

* * * * * [57]

Q. (By Mr. Doesburg): The question is, following the beginning of the strike, with whom did your Union enter into contractural relations, or make an agreement?

A. A number of plants.

Q. Name those companies.

A. Part of the Association? [58]

Q. Yes, sir. A. Central Litho.

Q. Central Litho made an agreement. Had they formerly negotiated as part of the negotiating group? A. Yes.

Q. Who else?

(Testimony of Theodore Brandt.)

Trial Examiner: I think what we are interested in is whether they were represented at that time by the Association, or whether——

Mr. Doesburg: They were. That is the point he just answered.

Q. (By Mr. Doesburg): Is that correct, they had been represented up to the time of the strike by the negotiating committee? A. Yes.

Trial Examiner: All right, that covers it.

Q. (By Mr. Doesburg): Who else did you make an agreement with? A. Graphic Press.

Q. The Graphic Press, and had they been represented by the negotiating committee up to the inception of the strike? A. Yes.

Q. Who else did you enter into an agreement with?

A. I can't recall who else from the Association.

Q. I will ask you, did you make an agreement with the Pacific [59] Coast Lithographic Company?

A. Yes.

Q. And prior to the time of the strike, had they been represented by the negotiating committee?

A. Pacific Coast, I can't recall whether or not they were part of the Association.

Q. You don't know whether they were included in the list which you had submitted to you by the Association?

A. I can't recall if they were part of it.

(Testimony of Theodore Brandt.)

Q. Would you like at this time to refresh your memory? A. Yes.

Mr. Doesburg: Mr. Grodsky, would you let him refresh his memory from the list?

Mr. Grodsky: Yes. No. 45.

The Witness: Yes. They are part of the committee.

Q. (By Mr. Doesburg): They were up to this time negotiated by the negotiating committee?

A. Yes.

Q. Did you make an agreement with Lou & Allen Lithographic Service? A. Yes.

Q. Prior to the time that you made this agreement, had they been represented by the negotiating committee? A. Yes.

Q. Did you make an agreement with the Trade Press? [60] A. Yes.

Q. Prior to this time had they been represented by the negotiating committee? A. Yes.

* * * * *

Q. Did you negotiate with either Western or General during this period? [61]

* * * * *

The Witness: I did not meet with them, no.

Q. (By Mr. Doesburg): Did you meet with any representative of either or both of them?

A. I met with a representative of one company to discuss negotiations, discuss contract.

Q. Which company was that man a representative of? A. General.

Q. General? A. Litho.

(Testimony of Theodore Brandt.)

Q. Is it not a fact, Mr. Brandt that you came to an agreement and that agreement was communicated to the negotiating committee on the 26th of March, 1958?

A. There was a lot of discussion, and we came to an understanding, but I have had many discussions with Employers during all of this time. [62]

* * * * *

Q. Then what did they do, did they indicate, either assent or dissent?

A. It wasn't they, of course. It was one individual who said that he would recommend it.

Q. Who was that individual?

A. Mr. Paganini.

Q. Who was Mr. Paganini?

A. An Employer of the General Lithograph Company.

Q. An Employer of General?

A. I mean an owner of the General Lithographic Company.

Q. Is he an officer of the General Lithograph Company? A. I would assume so.

Q. You don't know what capacity he holds with General? A. No, I don't.

Q. But he purported himself to be a principal of the General Lithograph Company, is that correct?

A. Yes.

Q. What was the status of your discussions when you and Mr. Paganini separated on March 26, 1958?

A. That he would try to effect a conclusion or

(Testimony of Theodore Brandt.)

ending of the [64] strike by recommending a proposal that would be satisfactory on both sides.

Q. Is it not a fact that predicated upon that statement by Mr. Paganini, that you proceeded to call a meeting of the Union for the 27th of March at approximately 2 p.m. in the afternoon to ratify that understanding?

A. I can't recall if it was predicated on that or if I had received a telephone call that that meeting was to be set up. I can't recall.

Q. You called a meeting of the Union for 2 o'clock in the afternoon of the 27th of March, did you not? A. Yes.

Q. When did you call that meeting, when did you notify your people to be present?

A. I believe the day before of the 27th, the 26th.

Q. That would be the 26th, is that correct?

A. Yes.

Q. At about what time did you notify them?

A. I can't—I can't recall the time. [65]

* * * * *

Q. (By Mr. Doesburg): Now, following your meeting with Mr. Paganini, what was the next conversation that you had with any member of the negotiating committee that you have described?

A. I believe I had a telephone call from the chairman of the committee, Mr. Frank Miller.

Q. What did he say?

A. That a meeting was to be arranged for 12 o'clock on the 27th.

(Testimony of Theodore Brandt.)

Q. Did he make any reference to any settlement with any other company?

A. I can't recall that he did.

Q. Did he tell you when he wanted to meet with you? A. Yes.

Q. When was that? A. 12 o'clock.

Q. At 12 o'clock on March 27th, 1958?

A. To the best of my memory.

Q. Was that meeting held? A. Yes.

Q. Where was it held?

A. It was held in the offices of the Printing Industry of [67] America.

Q. Who was present?

A. The Union negotiating committee and the Employer negotiating committee.

Q. The same people were present that you testified that made up the personnel of the Employers' negotiating committee? A. Yes.

Q. What took place at that meeting?

A. There was some discussion and Fred Miller then read off the proposal that——

Q. This is important. Let's have this discussion to the best of your recollection. What was that discussion?

A. Well, usually these meetings are quite excitable, and it would be very hard to remember what exactly took place.

Q. You know what subject was discussed generally, don't you? A. Yes.

Q. That isn't so long ago.

(Testimony of Theodore Brandt.)

A. No, but the general discussion was the proposal.

Q. To the best of your recollection, what was said? If Frank Miller called the meeting, who started out? A. Mr. Fred Miller.

Q. Fred Miller, and can you recall at all what he had to say, what he said at that time?

A. He wanted to know if I had met with someone else.

Q. What did you say? [68]

A. That I didn't expect to be put on the witness stand there. I found it unnecessary to answer.

Q. Did he say someone else, or did he name an individual?

A. I can't recall whether he specifically named anybody.

Q. If he did or did not name anybody, you refused to answer, is that correct, whether you had met with anyone or not?

A. I had been meeting with many people, and I thought it unnecessary to answer.

Q. The answer is, you did not answer Mr. Miller's question, did you? A. Yes.

Q. Yes, you—— A. I did not answer.

Q. Yes, you did not. Then what was the next thing to the best of your recollection that took place?

A. Mr. Miller said they had a counter-proposal to give us.

Q. To the best of your recollection, what was the counter proposal?

(Testimony of Theodore Brandt.)

A. Mr. Miller had a proposal and in discussing it held out the profit-sharing clause that we requested and over which we discussed and bargained during that session.

Q. In other words, he submitted a proposal which was a summary of what was discussed up to that date, minus the profit-sharing clause, is that correct?

A. Before the discussion started — Mr. — as to one, he [69] gave us this proposal when he immediately stated that if I insisted on the profit-sharing plan, then Jeffries Banknote Company would not be a signatory.

Q. In other words, you had your election; you could have the proposal of the negotiating committee, including Jeffries Banknote Company, or you could insist upon your existing proposal exclusive of Jeffries Banknote Company, is that correct?

A. I can't remember exactly how he put it, but I do know that I answered him by telling him that as far as our committee was concerned, the Jeffries Banknote Company was a part of these negotiations, and we would hold them liable. [70]

* * * * *

Q. And you took the agreement which included the profit-sharing plan which Mr. Miller had said excluded the Jeffries Banknote Company, is that not true?

A. In substance, yes. I took it with a statement that Mr. Jeffries would be responsible.

(Testimony of Theodore Brandt.)

Q. You were definitely informed that he was not responsible if you took that clause, is that not correct? A. Yes.

Q. And you accepted that proposal with the clause in it, you insisted on the proposal with the profit-sharing clause in it, did you not?

A. Yes.

Q. Now, then you left that meeting and went to a meeting of your own Union, did you not?

A. Yes.

Q. What took place at that meeting?

A. I recommended the proposal that the Employers had given us.

Q. So at that time this agreement was subject to ratification by your Union, was it not?

A. Yes.

Q. What was your procedure for securing ratification?

A. I read the proposal off to our membership, at which time [71] there was some discussion, and the members voted in secret ballot and accepted it.

Q. At that time did you advise them to return to work?

A. I advised them to return to work immediately.

Q. Did they return immediately?

A. They returned immediately. Some—they all returned immediately, but some were told there wasn't some work available, and it would be a matter of a day or two before they could go to work.

(Testimony of Theodore Brandt.)

Q. Now, by returning immediately, do you mean the same afternoon?

A. We suggested that they all go back immediately that afternoon.

Q. That would be approximately what time?

A. 3:30.

Q. Approximately 3:30. Do you know whether or not those employees returned to work at Jeffries Banknote Company?

A. They did not return to work that afternoon.

Q. Did they return——

A. They were willing to return to work. There was no work.

Q. They did not go to work? A. Yes.

Q. Did they go to work the next day?

A. No.

Q. Did you have any conversations with Mr. Jeffries with [72] regard, or any other member of Jeffries' organization, with regard to why they had not been put back to work? A. Yes.

Q. What were those conversations and with whom?

A. I spoke to Mr., to the best of my memory, I spoke to Mr. Jeffries, and as to whether or not—I spoke to Mr. Jeffries to find out when the men would go back to work.

Q. What were you told?

A. That it was a matter of not having enough work immediately, and Mr. Jeffries pointed out that he wanted to continue discussions, and I told him that I would consult with our Counsel and——

(Testimony of Theodore Brandt.)

Q. Now, is it not a fact, Mr. Brandt, that you called the Jeffries organization; you did not talk to Mr. Jeffries, you talked to Mr. Kellough, and you asked Mr. Kellough when the men would work, and Mr. Kellough informed you that he would have to consult with Mr. Jeffries. Is that not the truth, rather than what you testified to?

A. To the best of my recollection I also, I, to the best of my recollection, I had a conversation with Mr. Jeffries.

Q. Is it not a fact that you first had a conversation on the 28th of March with Mr. Kellough and Mr. Kellough told you that they did not have work available, and he would have to consult with Mr. Jeffries as to when the men could return?

A. It is possible. [73]

Q. Is it not true that you did not talk with Mr. Jeffries until the first day of April, 1958?

A. I can't recall the approximate date.

Q. Is it not a fact that at that time Mr. Jeffries informed you that he did not have an agreement, but if the men wanted to come back to work without an agreement, he would try to put them to work the following day, but at the latest the day after, which would be the second or the third? A. Yes.

Q. Is it not a fact that the men came back on the second day of April, 1958, working under the terms and conditions of the previous agreement, the 1956-58 agreement? A. Yes.

Q. And on April 1st, when you talked to Mr. Jeffries, did Mr. Jeffries not state to you that it was

(Testimony of Theodore Brandt.)

necessary now for you and he to get together to negotiate an agreement? A. Yes.

Q. Did you not say, "I understand that L, but I think I want to talk to my attorney and you probably want to talk to yours before we get together."

A. I can't remember the exact words, but I do know that I said I wanted to talk to my attorney.

Q. In essence, what I have just stated was the conversation you had with Mr. Jeffries?

A. Yes. [74]

Q. Now, upon the consummation of the agreement with the negotiating committee which I understand took place on the 27th, what is your procedure then for signing up the individual companies?

A. Our procedure is to get a master contract and then to get individual contracts.

Q. In other words, you take the master contract, as I understand it, and I believe this is Exhibit, General Counsel Exhibit 5, for the purposes of the record, and this contract is executed under the Employers' Committee by the names appearing on that exhibit, is that correct? A. Yes.

Q. Those names are Les Bennett, Frank Miller, Bob Orchard, Douglas Laidlaw and Fred Miller, is that correct? A. Yes.

Q. Now, is that the agreement with those names appearing on it the agreement which you mailed to the Employer, or do you make a facsimile signature, or do you send them out blank?

A. I believe they appear on the, the copies.

(Testimony of Theodore Brandt.)

Q. In other words, do you have them typed in, or do these people execute 47 copies?

A. The Association helps to get the contracts. They are the ones that——

Q. But when you send these contracts to the Employer—you testified you would send a copy of this agreement to the [75] Anderson Lithograph Company, is that correct? A. Yes.

Q. Would it or would it not have any signatures back on the signature sheet, and I call your attention to Page 12? A. They would.

Q. ——of the exhibit.

A. It would be in typewritten form. We would have them there.

Q. In other words, that is what I am asking. You would have typewritten signatures in where these individuals signed the original? A. Yes.

Q. Would the signatures appear in original or typewritten form? A. No.

Mr. Silverman: "These" meaning what, for the record?

Q. (By Mr. Doesburg): The Union officials.

A. No.

Q. They don't appear either in typewritten or in written form? A. No.

Q. It is blank? A. Blank.

Q. When you send it out? A. Yes, sir.

Q. To the Employer? [76]

A. No. One copy I sign myself and send to the Employer and suggest that he keep that copy, and the others send back to us.

* * * * *

(Testimony of Theodore Brandt.)

Q. And is Page 1 of Exhibit 5 in blank or is it filled out?

A. Page 1 is filled out as you see it.

* * * * *

Q. As you see it here.

A. The name is put up there.

Q. And who puts—— A. Our office.

Q. In other words, you office then, if this were to go to the Anderson Lithograph Company, you would have typed in on the first line after the word "between" the Anderson Lithograph Company, is that correct? A. Yes. [77]

* * * * *

Q. And you sent out 47, roughly, of these, three copies to each of the 47 Employers you described as being represented by the negotiating committee?

A. Yes.

Q. And you have a covering letter which goes with this agreement? A. Yes.

Q. What, in essence, does that covering letter say?

A. Enclosed find copies of our Union Label Agreements and the agreements negotiated between the Employers and Local 22, and we request that you sign and send back to us all these agreements.

Q. And then the firm may execute in the place where it says firm name, on Page 12? A. Yes.

Q. And then returns that copy to you, is that correct? A. Yes. [78]

* * * * *

(Testimony of Theodore Brandt.)

Q. And do you include Union Label Agreements with all agreements which you send out to Employers, General Counsel Exhibit 5? A. Yes.

Q. Do all of these 47 Employers, which you have described, or 46, execute the Union Label Agreement? A. No. [80]

* * * * *

Q. So it is optional with the Employer as to whether he signs the Union Label Agreement?

A. Yes. [81]

* * * * *

Q. Mr. Brandt, at the time we took the recess we were just discussing the mailing of the contracts, General Counsel Exhibit No. 5, to each of the Employers within the group of 46 or 47 which you described, and accompanying this was the Union Label Agreement.

Was one of these, or rather, was a set of these sent to Anderson Lithograph Company?

Trial Examiner: You mean both the Union Label and the Employers' contract?

Q. (By Mr. Doesburg): Yes. The kit that he said they sent [82] out to all Employers?

A. To the best of my knowledge it was sent, it was my instruction to our office force that they be sent.

Q. At about what date were those mailed out, do you know?

A. Approximately two, approximately two weeks after negotiations had ended.

(Testimony of Theodore Brandt.)

Q. In other words, that would be subsequent to the date on which you received General Counsel Exhibit No. 7.

A. March the—did you say subsequent?

Q. Subsequent.

A. This was received previous to my sending——

Q. Previous to your sending out the agreements?

A. Yes.

Q. And to the best of your knowledge, Anderson was on that list?

Trial Examiner: What is your answer?

The Witness: Yes.

Q. (By Mr. Doesburg): Do you know whether or not Jeffries was on that list? A. Yes.

Q. Now, is this the procedure which has been followed uniformly, since the, during the eight negotiating periods which you have described you have participated in? A. Yes.

Q. Over this 10-year period? [83]

A. Yes.

Q. Now, coming back to 1956, did you have, prior to the 1956-58 contract, did you have any negotiations with the Jeffries Banknote Company?

Trial Examiner: I didn't understand that. Will you read it, Mr. Reporter?

(Record read.)

The Witness: Yes.

Q. (By Mr. Doesburg): What were they?

Mr. Grodsky: May I have it fixed in time?

Mr. Doesburg: I did. I said prior to the 1956-58 contract.

(Testimony of Theodore Brandt.)

Mr. Grodsky: I know, but I mean 1948 would be prior to 1956.

Mr. Doesburg: That is right.

Mr. Grodsky: Then I still press for the time to be fixed.

Mr. Doesburg: I am asking if he ever had any prior to 1956. His answer was yes. My question was, when were those negotiations?

The Witness: Approximately 1951.

Q. (By Mr. Doesburg): What did those negotiations constitute?

A. Collective bargaining agreement negotiations.

Q. You bargained with the Jeffries Banknote Company? A. Yes.

Q. Did you arrive at an agreement? [84]

A. Yes.

Q. Was that agreement reduced to writing?

A. Not on the part of Mr. Jeffries.

Q. Will you explain that to us, please? What do you mean? How could you have an agreement if he did not agree to it?

A. Mr. Jeffries was part of the negotiations of the Employers' Negotiation Committee, and I thought he would sign like everybody else after concluding a contract.

After the contract was concluded, he refused to sign, and I asked him a number of times to sign. He refused to sign and stated that he would fight us on that point.

We made a few more requests, I personally made requests and at one point he stated that he was

(Testimony of Theodore Brandt.)

going to see the General Counsel of the Board, who he knew very well, in Washington, that if we wanted to fight we could have it, but he was not going to sign a contract. At that point we had other problems, we just dropped.

Q. So that he never did sign any agreement with you prior to 1956? A. Yes.

Q. Now, you didn't file any charges against Mr. Jeffries in 1951, after he refused to sign, did you?

A. No.

Q. What was the next thing that you did do in connection with Mr. Jeffries in approximately 1957?

A. We petitioned for an election.

Q. You filed a petition with the National Labor Relations Board for a certification as representative of his employees, is that correct? A. Yes.

Q. Was such an election held? A. Yes.

Q. Was the certification issued? A. Yes.

Mr. Doesburg: Will you mark this as Respondent's Exhibit No. 1 for identification?

(Thereupon the document above referred to was marked Respondent's Exhibit No. 1 for identification.)

Q. (By Mr. Doesburg): I show you Respondent's Exhibit 1 for identification, dated July 23, 1956, and ask you if you have ever seen that document before? A. Yes.

Q. I ask you whether or not that is the certification and order under which you bargained with Mr. Jeffries in 1956? A. Yes.

(Testimony of Theodore Brandt.)

Mr. Doesburg: If the Trial Examiner please, I will hold this and introduce it on direct examination.

Q. (By Mr. Doesburg): Now, following this certification, what was your next contact with Mr. Jeffries? [86]

A. We negotiated a contract. [87]

* * * * *

Q. Yes. In the Fall of 1957, or the Spring of 1958, what was the first contact that you had with Mr. Jeffries with regard to [93] bargaining an agreement?

A. Mr. Jeffries was sent a 60-day notice and a 30-day notice.

Q. Similar to those which you have previously described? A. Yes.

Q. Then what happened?

A. I believe that we had one or two meetings.

Q. Have you any idea when those meetings were held? A. No.

Q. Would it refresh your recollection if I suggested to you that it might have been, that it was during January, 1958, that you held two meetings with Mr. Jeffries?

A. Yes, approximately that time.

Q. Approximately January? A. Yes.

Q. 1958? A. Yes.

Q. What took place at those two meetings?

A. We discussed the proposal and it seemed that——

Q. You are referring to the Union's proposal which you submitted to him?

(Testimony of Theodore Brandt.)

A. Mr. Jeffries gave me the impression that he would go along with whatever was negotiated by the Employer, with the exception of the Union security clause or the profit-sharing plan, and he was using the profit-sharing plan as a lever to get the Union security clause eliminated. [94]

* * * * *

Q. And again I don't remember whether you answered me, did you at that first meeting submit a proposal to Mr. Jeffries?

A. I said I could not recollect.

Q. You don't remember.

No agreement was arrived at at this meeting, was there?

A. No.

Q. And the second meeting was held?

A. The second meeting was held.

Q. Can you tell us what took place at that meeting?

A. At that second meeting Mr. Jeffries asked me to contact my Counsel and see if we couldn't come up with something different [95] in the Union security clause than what we had.

Q. Very well.

A. Mr. Jeffries said at that time that he would sign a 10-year contract if we would eliminate that clause.

Q. What did you tell him?

A. That I could not eliminate that clause, that I would try to modify it, that I would contact my at-

(Testimony of Theodore Brandt.)

torney, which I did, and I then sent him a copy of the modification.

Q. You did then prepare a modification?

A. Yes.

Q. And you sent a copy of that to him. Approximately, do you know, when that was?

A. Sometime in February.

Q. Sometime in February? A. I believe.

Q. Was anything further done after you sent him that modification?

A. Not that I can recall. [96]

* * * * *

The Witness: No. Mr. Jeffries gave me to understand that he would go along with the economic package that the Employers would negotiate.

Q. (By Mr. Doesburg): Is it not a fact that following that meeting you had no further meetings with Mr. Jeffries? A. Yes. [97]

* * * * *

Q. Now, in negotiating with the committee, did Mr. Jeffries or any member of the Jeffries Banknote Company participate following March 17th, 1958, in the so-called negotiating committee's negotiations?

A. I didn't see any representative of the Jeffries Banknote Company. [99]

* * * * *

Q. I think you testified, didn't you, I think you said Frank Miller, it wasn't Frank, but you said it was Frank Miller advised you at the negotiations on March 27th that the Jeffries Banknote Company

(Testimony of Theodore Brandt.)

was not a party to the agreement if the profit-sharing clause was included. Was that your testimony?

A. The first time that I heard that the Employers were representing the Jeffries Banknote Company was at a previous meeting when I was notified by Mr. Miller that the committee was now representing the Jeffries Banknote Company. [100]

* * * * *

Q. Then, what was the next contact you had with Mr. Jeffries?

A. The next contact I had with Mr. Jeffries was when I spoke to him over the telephone.

Q. That is the testimony that we covered this morning with reference to April 1st, is that not true?

A. And I did not speak to Mr. Kellough.

Q. Not on April 1st. Did you speak to Mr. Jeffies on April 1st?

A. Approximately that time. [101]

* * * * *

Q. Do you know approximately when the San Francisco negotiations were completed?

A. San Francisco negotiations.

Q. In 1958?

A. Sometime in February.

Q. Do you know whether it was the early part or the latter part?

A. I think it was the latter part. [104]

* * * * *

(Testimony of Theodore Brandt.)

Redirect Examination * * * * *

Trial Examiner: Do you have any objection to its receipt?

Mr. Doesburg: No objection.

Trial Examiner: Received.

(The document heretofore marked General Counsel's Exhibit No. 9 for identification, was received in evidence.) [106]

[See pages 170-171.]

* * * * *

A. Yes. This is an answer to the previous one.

Q. To the letter of April 1, which is General Counsel 9, is that correct? A. Yes.

Mr. Grodsky: I will offer that into evidence.

Trial Examiner: Any objection?

Mr. Doesburg: No objection.

Trial Examiner: Received.

(The document heretofore marked General Counsel's Exhibit No. 10 for identification, was received into evidence.)

[See pages 172-173.]

* * * * *

Q. (By Mr. Grodsky): Did you in any way indicate your consent or acquiescence to the proposal that Jeffries should not be bound by the agreement? [107] A. Absolutely not.

Q. There was testimony that you had a telephone conversation with Mr. Jeffries on April 1st. During

(Testimony of Theodore Brandt.)

the course of that telephone conversation, did the question of whether Jeffries is subject to the negotiated agreement come up for discussion?

* * * * *

Q. (By Mr. Grodsky): Yes. Would you tell us what the discussion was concerning that subject?

A. I advised Mr. Jeffries that he was bound by what both committees had negotiated, that Mr. Jeffries felt he wasn't.

At some point there we said that we would consult our Counsels.

Q. Now, in any of your discussions, either with the [108] Association or with Mr. Jeffries or any representative of Jeffries Banknote Company, did you at any time consent to the proposition that you had achieved no agreement——

Mr. Doesburg: Objection.

Trial Examiner: Let him finish his question.

Q. (By Mr. Grodsky): ——with the Jeffries Banknote Company?

Mr. Doesburg: Objection.

Trial Examiner: It is a general question of whether he acquiesced.

Mr. Grodsky: That is right.

Trial Examiner: He may answer. Did you ever acquiesce in the action of Jeffries?

The Witness: Never, no, sir.

* * * * *

(Testimony of Theodore Brandt.)

Recross Examination

Q. (By Mr. Doesburg): Now, Mr. Brandt, I show you General Counsel Exhibit 10. I believe you testified that you sent that letter to Mr. Jeffries?

A. Yes.

Q. Did you ever discuss the contents of that letter with anyone? A. Yes.

Q. Who did you discuss it with? [109]

A. Counsel.

Q. Who is your Counsel?

A. Benjamin Robinson.

Q. How did you discuss it with Mr. Robinson?

A. I received a letter from Mr. Jeffries. I called Mr. Robinson.

Q. Now, you are referring to General Counsel Exhibit No. 9, the letter from Mr. Jeffries; you are referring to this letter here? A. Yes.

Q. You called Mr. Robinson, and what did you say?

A. I read the letter from Mr. Jeffries to Mr. Robinson.

Q. Did you ask him then what you should do?

A. Yes.

Q. What did he say to you?

A. That as far as we were concerned, we had negotiated a contract, that I was to send him this letter.

Q. As a matter of fact, Mr. Brandt, isn't the truth of the matter that that was the first time that

(Testimony of Theodore Brandt.)

you ever heard that Mr. Jeffries was covered by such an agreement? [110]

* * * * *

Trial Examiner: Had you ever heard before you were advised by your attorney that Jeffries was covered by the Employers' contract; do you understand?

The Witness: I would like that restated.

Q. (By Mr. Doesburg): When Mr. Robinson told you that you need not answer this, acquiesce, agree to this wage increase, that was the first knowledge that you had, wasn't it, that there was any thought that Mr. Jeffries was under the agreement which you had negotiated on the 27th?

A. Well, at the—we discussed what happened at the last meeting.

Q. Right.

A. Where I was given to understand that Mr. Jeffries would not go along.

Q. So Mr. Robinson was the one that suggested that he might have to go along, was he not?

A. Well, at that point I stated to the Employers that Mr. Jeffries was bound by what was negotiated by this committee.

Q. You stated that on the 27th?

A. Absolutely.

Q. And there were how many people present, and who were they?

A. Approximately 12 people. [111]

* * * * *

(Testimony of Theodore Brandt.)

Q. (By Mr. Doesburg): Let's get the name of each person that was present at the meeting of the 27th?

A. You want me to state them?

Q. Yes, sir.

A. From my committee there was Mr. Resnick, Mr. Art Moody, Mr. George Claremont, Mr. Henry Lehman, myself.

The Employers, there was Mr. Anderson, Mr. Fred Miller, Mr. Bob Orchard, Mr. Les Bennett, Mr. Douglas Laidlaw, Mr. Frank Miller, another representative of the Employers, but just offhand I can't remember his name.

Q. Is it your testimony that you told them at that time, approximately noon on March 27th, that you considered Jeffries covered by the agreement?

A. Yes.

Q. Very well. Now, we come back to when you read this to Mr. Robinson. What did Mr. Robinson tell you?

A. Mr. Robinson said that this was dastardly. That was his opinion of the letter. [112]

* * * * *

Q. What else did he tell you?

A. And we would answer his letter, and we did answer it.

Q. Who is "we"?

A. Or I would answer the letter.

(Testimony of Theodore Brandt.)

Q. Who is "we"?

A. Mr. Robinson and Mr. Brandt.

Q. Is it not a fact, Mr. Brandt, that Mr. Robinson dictated this letter to you over the phone?

A. He dictated it to the girl, not to me.

Q. He dictated to the girl in your office?

A. Yes.

Q. On what date was that that he dictated that letter to the girl in your office?

A. On the 3rd.

Q. On the 3rd of April, and what was the date of your conversation with Mr. Robinson at which he dictated this letter to the girl in your office?

A. On the 3rd.

Q. That was the 3rd of April? And thereupon the girl typed the letter?

A. I don't know how to type.

Q. I didn't say you typed it. Did she type it?

A. Yes.

Q. Did she put it on your desk? [113]

A. Yes.

Q. Did you sign it? A. Yes.

Q. And did you mail it? A. Yes.

* * * * *

MAX RESNICK

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows: [114]

Direct Examination

* * * * *

Q. (By Mr. Grodsky): Are you a member of Local 22?

A. Yes, sir. I have been the vice-president for the past two years.

Q. Have you also been a member of the negotiating committee? A. Yes, sir.

Q. Were you present on March 27th at the negotiating meeting at which the agreement was concluded, was reached?

A. Yes. Up at the P.I.A. Building. [115]

* * * * *

Q. Will you tell us as to the best of your recollection what was said at that negotiating meeting, and by whom, if you recall?

A. Well, at the time when the profit-sharing statement come up and Fred Miller made the statement that if that was included in the contract, Mr. Jeffries wouldn't, wouldn't go along with it.

Mr. Brandt got up and made the statement that he would have to abide by anything that was settled in this room.

Q. When you say he would have to abide, who do you mean?

(Testimony of Max Resnick.)

A. Well, Mr. Jeffries. Jeffries Banknotes Company. They were obligated to follow what the negotiating committee of the P.I.A. had negotiated.

Q. Did you have any conversation with any representative of Jeffries Banknote Company after the agreement was reached? A. Yes, sir.

Q. When did you have such conversation? [116]

A. March the 28th.

Q. With whom did you have the conversation first?

A. Well, I saw Tommy Kellough at 9 o'clock on Friday morning.

Q. What was the conversation between you and Mr. Kellough?

A. Well, I went down to see Tommy Kellough because all our men had reported into work and the foreman of the floor said that there was no work, that we should all go home, and so I went down to see Mr. Kellough and told him now that the contract had been concluded with the negotiations committee and the Employers that it is up to the firm to see that the men got to work as quickly as possible.

Mr. Kellough told me that at that time that he couldn't tell me one way or the other, that I would have to see Mr. Jeffries, and I was told to call back there and make an appointment with Mr. Jeffries.

Q. Did you see Mr. Jeffries?

A. Yes, sir. I called back and got an appointment with Mr. Jeffries that same day.

(Testimony of Max Resnick.)

Q. Approximately what time did you see Mr. Jeffries?

A. I would say the approximate time of that interview would be about 11:15 in the morning.

Q. On what day is that again?

A. That was March 28th.

Q. Who was present at the time of that interview?

A. Mr. Jeffries and myself. [117]

Q. Will you tell us what he said and what you said?

A. Well, I went over to see—the same thing that I went over with Mr. Kellough in the morning. I told him that now that the contract had been concluded with the Association, I thought it was up to them to get the men back in the plant as soon as possible, and not only the men would benefit but also the concern, and at that time Mr. Jeffries said that due to the lack of work, why, they couldn't put the men on immediately, but they would be notified when to come back to work.

Q. Is that all of the conversation that you can recall at this time?

A. Outside of talking about the Brooklyn — I mean Los Angeles Dodgers.

Q. At that time by whom were you employed?

A. Jeffries Banknote Company.

Q. Have you had any contact with any representative of the company with reference to this matter since that date, that is, since March the 28th?

A. Do you mean management?

(Testimony of Max Resnick.)

Q. Management.

A. Or people at work?

Q. Management. A. No, sir.

Q. Were the men subsequently called and told to come back by the company? [118]

A. Yes, sir. I think the men all went back to work on Wednesday, April the 3rd.

Mr. Grodsky: No further questions.

Cross Examination

Q. (By Mr. Doesburg): Do you know, were you working there on April the 3rd?

A. Yes, sir.

Q. At the time that they went back to work, do you know whether or not they went back to work under the terms of the 1958 agreement, or the '56 agreement?

A. We went back under the old terms.

Q. Under the '56 agreement?

A. Yes, sir. [119]

* * * * *

Q. (By Mr. Doesburg): Let's see if I have your quotation correctly. What was it you said Mr. Brandt said on March 27th with reference to Jeffries?

A. That he would have to abide by the negotiating committee.

Q. He would have to abide by the negotiating committee? A. Agreement.

Q. Or he would have to abide by the agreement?

(Testimony of Max Resnick.)

A. The agreement. This was settled up at the P.I.A. Building.

* * * * *

Q. When you saw Mr. Jeffries, I think you testified that Mr. Jeffries said that he couldn't use the men right at the present [124] time, that the work was farmed out, but that he would be in touch with you; is that what you said?

A. No, sir. I said that he would get in touch with the men that were working upstairs.

Q. He would get in touch?

A. He would either call them or have them called by telephone or wire them.

Q. Do you know whether or not Mr. Jeffries did that?

A. To the best of my knowledge I believe they all received a wire.

* * * * *

Mr. Grodsky: I will offer to stipulate with Counsel if he wishes that the text of the wire was as follows:

"Glad to advise you that work will be available Tuesday, April 1. Please report regular shift-time. Previous work conditions are in effect pending negotiations for new contract. Signed, Al Jeffries."

Trial Examiner: Does Counsel accept the [125] stipulation?

Mr. Doesburg: Yes. [126]

* * * * *

ALLERTON H. JEFFRIES

a witness called by and on behalf of the Respondents, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Doesburg): Are you employed by Jeffries Banknote Company? A. Yes.

Q. In what capacity?

A. President. [128]

* * * * *

Mr. Doesburg: At this time I would like to offer into evidence Respondent's Exhibit No. 1 for identification.

Mr. Grodsky: No objection.

Trial Examiner: Received.

(The document heretofore marked Respondent's Exhibit No. 1 for identification, was received in evidence.) [129]

[See pages 173-174.]

* * * * *

Q. (By Mr. Doesburg): Then, following the election, Mr. Jeffries, what was the next that you heard from Mr. Brandt?

A. Several days later Mr. Brandt called and suggested that we get together to discuss the contract.

Q. Did you get together and discuss a contract?

A. I did.

Q. Did that result in an agreement?

A. It did.

(Testimony of Allerton H. Jeffries.)

Q. I show you Respondent's Exhibit No. 2 for identification, and ask you whether or not that is the agreement? A. That is. [130]

* * * * *

Q. Prior to the 1st of February, 1958, did you have any conversations or negotiations with Mr. Brandt? A. I did.

Q. Will you tell us what they were?

A. With Mr. Brandt or representatives of the Union?

Q. Either one.

A. Either Mr. Brandt or Mr. Carlson telephoned, suggesting that we get together for preliminary discussions prior to the expiration of the contract, and Mr. Brandt was out of the city for—Mr. Carlson came in and Mr. Kellough of our office and Mr. Carlson discussed briefly the renewal or the possibility of our getting together for the negotiation of a new contract, and we both agreed that we hoped we could do so amicably. [132]

* * * * *

Q. Following this meeting, what was the next thing that took place?

A. During the month of January, after Mr. Brandt returned, he phoned and asked if he could come over and discuss further negotiations for a new contract, which he did at that time, just Mr. Brandt and myself were present.

I told him of my feeling regarding the Union shop clause in the contract, which he well knew. He said he would discuss the matter with the Amal-

(Testimony of Allerton H. Jeffries.)

gamated General Counsel and see what he could do regarding the situation.

Q. Was that all that took place at that meeting?

A. Some discussion was held on our profit-sharing plan and I reiterated our stand as far as that is concerned.

Q. Then, did you adjourn to a further date, set a date or——

A. Mr. Brandt said he would get in touch with me further after he had had a chance to discuss the Union shop clause in the proposed new contract with General Counsel.

Q. Was any reference made at that time to negotiations in San Francisco?

A. I asked Mr. Brandt how the negotiations were getting along with the local Employers' group, and the Union, and he [133] said they had been suspended, pending the outcome of negotiations in San Francisco.

Q. When was the next time that you got together with Mr. Brandt, or what was the next you heard from Mr. Brandt?

A. The next I heard from Mr. Brandt was about three days prior to his instruction to his members not to work overtime.

He telephoned me to say that he had received from his General Counsel a proposed modification of the area or the contract which they were discussing with the Union Employers' group, and if we would agree to that he would not call our people out on strike.

(Testimony of Allerton H. Jeffries.)

I asked him to mail that to me so that I could look it over.

Q. Did he mail it to you? A. He did.

Q. What was the next thing that happened?

A. The next thing that happened, several days later he informed our employees not to work overtime. [134]

* * * * *

Q. Then, what was the next thing that you did?

A. In view of the fact that they had called a strike on the Employers, which I thought was completely unjustified, we decided that we would join the Union Employers' group, which we did so by sending a letter of authorization to them and also notifying the Union that the Union Employers' Section of P.I.A. would represent us.

Q. Did any official of the company serve as a member of that negotiating committee?

A. No.

Q. Was that notification in the form of General Counsel Exhibit No. 4-A and 4-B, which have been introduced here into evidence?

A. No. It was a letter which I wrote directly to Mr. Brandt and also to the Union Employers' Section.

Q. I show you General Counsel Exhibit 4-B, and ask if that is the letter which you sent to Mr. Brandt? A. Yes.

Q. Advising him. That is what you had reference to as to the notification? A. Yes.

(Testimony of Allerton H. Jeffries.)

Q. Notifying them you had joined with them. Did you have any further meetings with Mr. Brandt? A. No. [135]

* * * * *

A. I attended the meeting with the rest of the Employers, the meeting called the morning of March 27th prior to the final meeting of the negotiating committee of both groups.

Q. Will you tell us what took place at that meeting?

A. I was late in getting there, but the substance of the meeting was that the negotiating committee had been notified that Western Lithograph Company and General Printing Company had agreed to the terms of a contract with Mr. Brandt of the day previous.

The Employers were all notified to that effect.

Q. Would that be March 16th, 1958?

Mr. Grodsky: 26th.

Q. (By Mr. Doesburg): Or March 26th?

A. March 26th, yes. There was quite some discussion regarding the thing. A vote was taken as to whether the Employers would go along with the negotiating committee. The majority voted to go along with the negotiating committee.

Frank Miller, who was chairman of the committee, stated that any of the Employer members who had previously signed an authorization for the Employers' group to represent them, could withdraw from their, could withdraw their authorization by

(Testimony of Allerton H. Jeffries.)

notifying the Employers' Committee that they would do so.

Q. Do you know whether or not Mr. Anderson then notified the company of any action on his behalf? [136]

A. It is my understanding that he did.

Q. You didn't see him do it? A. No.

Q. Did you notify the committee that you would not, would or would not, go along?

A. We did.

Q. How did you notify them?

A. Mr. Dale Magor, our vice-president, told Frank Miller, the secretary of the Union Employers' Section, that we would not go along.

Q. Thereupon, did you remain at the meeting?

A. No, I left.

Q. Were you present at any other meetings held on March 27, 1958? A. No.

Q. What was the next that you knew of any negotiations between the committee and the union?

A. Well, I guess the next I knew was the following morning, when I came into the office. Tommy Kellough told me that Max Resnick had been in to notify him that the negotiations had been concluded and that the employees wanted to come back to work.

Q. Did Mr. Kellough say anything that he had said in response thereto?

A. He told Mr. Resnick that all of our work had been farmed out, that we consequently had no work in the plant at the [137] present time, and

(Testimony of Allerton H. Jeffries.)

that he could talk to me if he wanted to regarding the situation, which he subsequently did, as he has testified.

Q. When was that conversation with Mr. Brandt?

A. Well, this is a conversation with Mr. Resnick.

Q. With Mr. Resnick. You had a conversation with Mr. Resnick?

A. That's right. That was Friday morning, the 28th.

Q. What did he say to you, and what did you say to him?

A. Mr. Resnick said that the negotiations had been concluded, that the men would like to come back to work.

I told Max that we would like to have them come back to work as soon as we had some work for them to do. However, we did not have a contract with the Union, and I didn't know whether or not Brandt would allow the men to come back to work under the circumstances.

Q. What did he say?

A. He wanted to know how we were getting along collecting money to the Dodger Baseball Team within the election.

Q. Was that the end of the conversation?

A. Yes.

Q. Did you subsequently talk with Mr. Brandt?

A. I came into the office on Monday morning, and Mr. Kellough said that Mr. Brandt had tele-

(Testimony of Allerton H. Jeffries.)

phoned him regarding the men coming back to work and Mr. Brandt wanted to talk with me.

Q. What did you do? [138]

A. I, as I recall, you came in to town that day, and I picked you up and we had lunch and came back to the plant and I telephoned Mr. Brandt and Mr. Brandt said he would like to have the men go back to work as soon as possible because they needed the work.

I explained the situation to him and all of our work had been farmed out, that we had nothing available. However, we would put them back to work.

Q. Take it a little slower, because the Reporter has to get all of this, and you are going pretty fast.

A. That we would put them back to work as soon as we could and I assume that his requesting me to put the men back to work meant his acquiescence to the fact that they go back to work without a contract.

He said he realized that there was no contract between Amalgamated and ourselves, but that he hoped that we could amicably negotiate one; but that the situation was rather complicated. He would like to talk to his attorney and he assumed that I would like to do so likewise.

Q. Was there anything further in that conversation said by either of you?

A. Not that I recall.

Q. Following this conversation with Mr. Brandt, did you notify the men to return to work?

(Testimony of Allerton H. Jeffries.)

A. We did. [139]

* * * * *

Q. Following their return to work, did you address any communication to Mr. Brandt with regard to changing the conditions of employment?

A. I did. We had never objected to the increased wage scale which they wished to put into effect, so I wrote Mr. Brandt a letter requesting that, or suggesting that we put the new wage scale into effect so as to not to penalize the men, pending our negotiation for a new contract; but asking him to stipulate that we do so without prejudice to anything we might negotiate.

Q. I show you General Counsel Exhibit No. 9 and ask you whether or not that is the communication which you have just described?

A. It is. [140]

Q. Did you receive a reply from this communication?

A. I received a reply from him, but not in answer to the wage question which he didn't mention in his letter. I have forgotten the contents of the letter which I received from him, other than the fact that he omitted to mention anything about the wages.

Q. I show you General Counsel Exhibit No. 10, and ask you whether or not you recognize that as the reply? A. Yes. [141]

* * * * *

(Testimony of Allerton H. Jeffries.)

Q. So that you have, following your second letter, you have had no further conversations with, or correspondence with, Mr. Brandt? A. No.

Q. Has he at any time asked you to meet with him—— A. No.

Q. For the purpose of bargaining?

A. No.

* * * * *

Q. I show you General Counsel Exhibit No. 2, and ask you whether or not you have executed such an authorization? A. No.

Q. Did you ever hear from Mr. Brandt or any other source the statement that you were included within the scope of the negotiations contained in General Counsel Exhibit No. 5, other than the letter of April 3rd which you received from Mr. Brandt?

A. No.

Q. That was the first notification that you had received from him to that effect? A. Yes.

Q. The next thing that you knew was this procedure, the charge in this proceeding? [142]

A. Correct.

Mr. Doesburg: That is all I have.

Cross Examination

Q. (By Mr. Grodsky): Mr. Jeffries, were you familiar with the terms of the authorization that Employers sign, authorizing the Association to represent them?

A. I have never seen a copy of it, no.

* * * * *

(Testimony of Allerton H. Jeffries.)

Q. (By Mr. Grodsky): Now, I show you a copy of your letter of March 14th, which is General Counsel Exhibit 4-B, and did you at that time advise the Union that you had authorized the Association to represent you?

A. Yes, sir, I did by this letter.

Q. Did you know the scope of your bargaining agent's authority? A. Yes.

Q. Did you know that your bargaining agent customarily had the authority to represent you until after an agreement had been executed? [143]

A. As I remember, I was told by Fred Miller, the Secretary of the U.E.S., we could withdraw any time we so notified the Union and the U.E.S.

Q. You didn't notify the Union of any limitation of the authority of the bargaining agent, did you?

A. We did at the final meeting, yes.

Q. You weren't present when the Union was notified?

A. No, but the chairman was so notified and in turn he so notified the Union Employers' Committee.

Q. Now, were you represented by the Employers' Committee at the time when the strike was called?

A. Yes.

Q. How long had you been represented by them before the date that the strike was called, if you recall?

A. Only a few days. I think this letter to the Local, advising them of our designation of the

(Testimony of Allerton H. Jeffries.)

Union Employers' Section, is dated March 14th. I believe the strike was called about a week later, three or four days' later.

Q. Do you recall why, or was there any economic pressure put on you by the Union immediately prior to your designation of the Association as the bargaining representative? A. Yes.

Q. What was the nature of that?

A. Instructing our employees to refuse to work any overtime.

Q. Was that the same day or the day immediately preceding the [144] time when you decided to be represented by the Association?

A. When the Union applied that economic pressure is when we decided to join the Union Employers' group.

Q. Now, after the meeting of the Employers on March 27th in the morning, did you give a written authorization to the Employers' Association, or did you in writing withdraw your authorization which previously had been given? A. It was verbal.

Q. It was verbal.

Trial Examiner: What was the nature of your authorization? Was it verbal, also?

The Witness: Our original authorization was in writing. The chairman of the negotiating committee for the Employers made the announcement that after these two other firms had negotiated separately with Mr. Brandt, that any of the Employers represented at the meeting could withdraw by

(Testimony of Allerton H. Jeffries.)

just stating, just notifying the negotiating committee of the Employers' group. [145]

* * * * *

Q. (By Mr. Grodsky): Do you recall in the Employers' meeting of March 27th, in the morning, whether you withdrew from the Association, or was your withdrawal contingent upon them not securing a satisfactory agreement. Do I make myself clear?

A. Well, yes, but it is a little broader than that. We have never been a member of the Union Employers' Section of Printing Industry's Association, so it wasn't a question of withdrawing from the Association.

All we were doing was withdrawing our authorization for the Employers' negotiating group to represent us in bargaining.

Q. Now, then, I will rephrase my question. [148]

Did you absolutely and unequivocally withdraw your authorization for the group to represent you at that time, or did you only withdraw it on the condition that they could not get a satisfactory agreement and you agreed to be bound by the action of the group if they could reach a satisfactory agreement?

A. I left the meeting early because I had another meeting scheduled, and I told Mr. Magor, our vice-president, that we were going to withdraw our authorization for the group to represent us any further because of what had transpired.

Mr. Magor in turn passed the information on to Mr. Douglas Laidlaw, who acted as chairman of

(Testimony of Allerton H. Jeffries.)

the Employers' group after Frank Miller, the previous chairman, had resigned; and in the transmittal of the message, Mr. Magor said to Mr. Laidlaw that he thought Jeffries might go along if the profit-sharing plan was not included in the final agreement. [149]

* * * * *

JOHN ANDERSON

a witness called by and on behalf of the Respondents, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Doesburg): Are you a member of the Union-Employers Section of the Printing Industry of America? A. I was. [155]

* * * * *

Q. Will you tell us how those negotiations are conducted?

A. The prior negotiations, I have not got much idea of how they were. Of course, the recent ones were the first time I was on the negotiating committee, for the first time.

Do you want me to describe the——

Q. I will ask a question, sir.

By "the first time," you mean the negotiations which transpired in 1957 and 1958?

A. Yes. [156]

* * * * *

(Testimony of John Anderson.)

Q. Very well. Will you tell us the events which transpired beginning along with your meetings with the Union in March, 1958?

A. Well, we kept coming closer by exchanging agreements, coming closer to a settlement. It seemed to me, as a member of [157] the Negotiating Committee, that they came down, we came up; we were, I thought on the way to approaching a San Francisco settlement.

* * * * *

A. And I think it was approximately a week prior to the strike being called, the Union called sanctions as eliminating all overtime; that is, the men were not allowed to work any overtime, and then we had a final meeting where we couldn't come to an agreement, and the Union called a strike.

Q. That was approximately when?

A. I am not too sure; somewhere around March 17th, or that area.

The strike was going along; we had no further meetings with the Union. It was proceeding as strikes do proceed; pickets, et cetera, and the next thing I know was a call for a meeting at approximately ten to ten-thirty a.m. in the Printing Industries Offices. This date, I believe, was March 27th, was it? [158] I mean, it has been brought up here before.

And the Union at that time had typewritten terms, I mean, as to what a settlement was purported to be.

This is all I can say here; I am under oath. Pur-

(Testimony of John Anderson.)

ported to be a settlement of Western and Central that they had made with them, and this was supposed to be a pattern.

Q. This was a report made to your committee, is that correct? A. Yes.

I must state at this time that prior to this, at the Employers' meeting, when I had questioned Mr. Youngquist of General Printing closely as to their intent; in other words, witnesses were there to bear me out, I asked Mr. Youngquist whether he was definitely committed to an agreement with the Union, or could he still back out.

Q. Was this about that time?

A. Yes, ten-thirty, eleven o'clock.

Q. On the 27th of March?

A. Yes, and I wanted him to publicly state this for the benefit of the rest of the association members who were there that belonged to the group, so they would know where they stood and not hearsay, and he stood up and said that his company was definitely committed to this agreement that had been read over by Mr. Miller, Fred Miller, as the terms of settlement.

At that time, Mr. Miller—prior to that had said that anyone wishing to revoke, considering the defects of those two [159] large firms had broken up the whole shebang, that anyone who wished to revoke their authority should sign and state that they wish to revoke, of which I was one that did at that time.

(Testimony of John Anderson.)

Q. You then indicated to the group that you revoked your authority?

A. Yes, and that I would not in any caucuses which we held subsequently, I would not have any say; I would not vote on any of the issues, and did not care to, because I had told them then that I had revoked, and should not have anything more to say about the settlement.

Q. What was the next meeting that was held?

A. There wasn't much time. Things, as Mr. Brandt said yesterday, were quite excitable. The employers walked out, and the Union Negotiating Committee walked in.

Q. Were you present at the meeting between the Union Negotiating Committee and the Employers Negotiating Committee? A. Yes.

Q. What took place?

A. Well, the terms were brought out, and I think there was a typewritten sheet that members of the Employers Negotiating Committee had that was furnished to them. I do not know who furnished it, frankly, it may have been from Mr. Brandt, of the terms of settlement. At that time—I hope my memory is right—this is the first time I personally knew of the added clause pertaining to the profit-sharing plan. This had not, [160] to my knowledge, that I remember, ever come up in the six months of negotiation prior to this time and, well——

Q. Let me ask you this: Who acted as chairman on behalf of the employers at this time, do you remember? A. Douglas Laidlaw.

(Testimony of John Anderson.)

Q. He acted as spokesman with the Union?

A. Yes.

Q. Can you tell us, then, what took place?

A. Well, to tell you the truth, I spent an awful lot of time just looking out the window; I walked away from the table. It was kind of like a Dunkirque to me.

Q. Just tell us what took place, Mr. Anderson.

A. The thing was settled; in other words, there was agreement that the Union-Employers group accepted the terms that the Union had laid down. That is just about it.

Q. Was there any reference made at that meeting to the Jeffries Banknote Company?

A. Yes.

Q. What reference was made?

A. Mr. Laidlaw took the position that if that clause was the profit-sharing clause, the Jeffries Banknote Company could not go along with it.

Q. Did Mr. Brandt respond to that statement?

A. The best of my recollection, he did.

Q. What did he say? [161]

A. He said the clause would stay in.

Q. That was all?

A. That is about what I remember. As I say, I was wandering around quite a bit, but I do remember that he didn't accede to the clause coming out.

* * * * *

Q. Prior to the negotiations which you now have just described, specifically 1956, after negotiation,

(Testimony of John Anderson.)

did you receive an agreement in similar form to General Counsel's Exhibit No. 5?

A. Yes, I did.

Q. Was that after negotiations had been consummated? A. Yes.

Q. Did you then execute that agreement?

A. Yes. [163]

* * * * *

Cross Examination * * * * *

A. Mr. Miller notified Mr. Brandt that the Culver Citizen News had revoked, and Mr. Brandt, somewhat like myself, can blow his top pretty easily, and he got to a boil, and I looked at Miller—and he will bear me out—I said, "Don't tell them about me, or that will blow this whole thing up." I thought that was the best thing with the Union meeting at two o'clock, and this meeting was already into a quarter to one about blowing this thing up, and getting Brandt all steamed up again—Miller will bear me out—I said, "You better not mention this now." It is that simple.

Q. (By Mr. Grodsky): In other words, did you not want—you didn't want to jeopardize the negotiations, is that it?

A. For my fellow members, yes.

Q. You felt that if this were known to Mr. Brandt, it might affect the action he might take with reference to negotiations?

(Testimony of John Anderson.)

A. I am afraid so, yes.

Q. Did you sign a written document to indicate that you resigned? A. Yes. [166]

* * * * *

Q. At the meeting at which you were present, at the employers' meeting in the morning, when, you say, you announced that you would not be bound, did any other employer representatives announce that they did not wish to be bound by the Association bargaining?

A. This was not an announcement. It was never announced, sir, to the general meeting. It was a signed, it was a pad left there to be signed; no one knew who signed it. [169]

Q. Was it just one signature to a page, or was it—— A. No.

Q. Or was it a group of signatures?

A. "These signatures hereby revoke," or whatever it was.

Q. It was in the form of a petition?

A. There were two others besides myself.

Q. Who are they, if you recall?

A. One was scratched out. The other was Culver Citizen News.

* * * * *

FREDERICK L. MILLER

a witness called by and on behalf of the Respondents, being first duly sworn, was examined and testified as follows:

Direct Examination

Q. (By Mr. Doesburg): Will you please state your name and address?

A. Frederick L. Miller, 1434 West 12th Street, Los Angeles.

Q. By whom are you employed?

A. The Union Employers Section of the Printing Association.

Q. In such capacity, what are your duties?

A. As Union Employers Section, my work involves the negotiation and the administration of labor contracts affecting the printing trades. [170]

Q. For how long have you been so employed?

A. Two years.

Q. Calling your attention to September of 1957, will you tell us the events leading up to the formation of a Negotiating Committee?

A. Well, prior to September, 1957, I had discussed the forthcoming negotiations with Mr. Brandt. At that time, he pointed out to me that perhaps it would be advisable that we commence negotiations before the re-opening dates of the contract, which would be December 1st of 1957.

He called my attention to the fact that in some previous negotiations, considerable pressure and tension had built up as they approached the expiration date of the contract, and he felt that it would

(Testimony of Frederick L. Miller.)

probably make for more peaceful negotiation if we commenced at some point prior to September 1, 1957.

I discussed this matter with the Negotiating Committee, and they felt there was some merit in what Mr. Brandt said, and we felt that the Union and the Employers would meet on September 17, 1957, at which time we would commence negotiations.

Q. Was such meeting held?

A. Such meeting was held at the headquarters of the Union.

Q. Will you tell us what took place?

A. There was an exchange of proposals by the parties. The initial meeting was not too long. A brief discussion was held. [171] We had asked the Union at that time to give us a sort of summary to their reasons for asking the changes in their proposal.

The Union in their turn asked us to explain the reasons why we had asked for the changes enumerated in our proposal.

I think that was all that was accomplished at the first meeting.

Q. Approximately how long was it before another meeting was held?

A. I do not have any record of the dates of the meeting. I should imagine that it was probably within two weeks that the second meeting between the parties was held, and we continued to meet at intervals thereafter.

(Testimony of Frederick L. Miller.)

At one point in the negotiations, we agreed to suspend further meetings. It was the feeling then of the employer group that due to the prolongation of the negotiations in San Francisco that Local 22 was unable to reach any sort of definite bargaining position, and pending clarification of the San Francisco negotiations, we felt that no headway could be made in trying to reach a settlement with Local 22.

I think Mr. Brandt disagreed with that statement; he said he was willing to negotiate a settlement with us, but it was the feeling of the entire employer group that until the San Francisco situation clarified, that Local 22 could not be serious as to the final terms of a settlement.

Q. Approximately when was the San Francisco settlement made? [172]

A. Approximately March 10th.

Q. Did you then meet again with Local 22?

A. Well, we had met with Local 22 prior to the settlement in San Francisco because in February, when we had made a wage offer to the Union of 8 cents an hour, that was five months after negotiations had passed. At that time, the Union package to the Employer had been revised, but after revisions, it still represented a package cost of 80 cents an hour, which we felt was outlandish, and certainly, no settlement could be reached on the basis of a proposed 80-cent package. [173]

* * * * *

Q. (By Mr. Doesburg): Mr. Miller, if you can in these cases, we would like to have it was re-

(Testimony of Frederick L. Miller.)

ported by whom and approximately when. We are attempting to show here a motive for action, your action and the Negotiating Committee's action.

A. I do not think I can recall at this date who informed the Employer or the Negotiating Committee that at least four companies had entered into a private understanding with the Union. I have the names of the companies. I also can testify that a copy of the memorandum agreement arrived at between the Union and one of those companies was given us.

Q. Which company was that? [175]

A. I think it was Central Litho.

Q. The memorandum agreement was presented to the Negotiating Committee? A. Yes.

Q. Proceed.

A. When this information was given the Negotiating Committee, the matter was referred to the attorneys that private negotiations were being conducted by Local 22 with companies that we had authorizations from, and the attorneys then addressed a letter to Local 22 that these companies were being represented by the Union Employers Section, and such private negotiations should cease.

Q. Are you referring in that to the communication, General Counsel's Exhibit 3? A. I am.

Q. Proceed.

A. The next information that I received of individual negotiations taking place between the Union and other companies came as a result of a telephone call I received while I was at my home, approxi-

(Testimony of Frederick L. Miller.)

mately 4:30 in the afternoon of March 26th. I was asked to be present at an emergency meeting of the Negotiating Committee at five o'clock. I attended this meeting along with other members of the Negotiating Committee with the exception of John Anderson, who, I believe, could not attend. All others were there. [176]

Q. Where was this held?

A. Out on La Cienega Boulevard; the Tail O' the Cock.

Q. Is that a public restaurant? A. It is.

Q. Proceed.

A. Shortly after I had arrived, Mr. Frank Miller of Western Lithograph then arrived, and said that he had asked for this emergency meeting because he had been given information shortly before that same afternoon that his company and General Printing had entered into an understanding with the Union concerning terms of a settlement, and that the terms of the settlement were acceptable to his company and to General Lithograph and the Union, and that those two companies would not continue with the strike. He provided each member with a copy of the terms of settlement agreed to by those companies. They are dated—this memorandum is dated March 26th, with the time of 4:15 p.m. on the bottom lefthand corner.

Q. That is the terms of settlement between General Printing and Litho? A. That is right.

Q. Western Litho Company and Amalgamated, Local 22? A. That is right.

(Testimony of Frederick L. Miller.)

Q. Proceed.

A. Mr. Frank Miller then informed the Committee that this would be the basis or, rather, the only basis upon which this [177] strike could be settled and that the Union expected a meeting with the Employer and Negotiating Committee the following morning.

The whole situation was then reviewed by the Employer and Negotiating Committee, and we felt we could do nothing with reference to a meeting with the Union until there had been a meeting with the companies we represented to advise them of these developments which had taken place, and we arranged to call a March meeting of the companies that we were representing for approximately eleven o'clock, half-past ten, eleven, on the morning of the 27th. Phone calls were made on the morning of the 27th to all the firms, and a meeting was held.

At that meeting, Mr. Frank Miller stood up and tried to give a statement of what had happened, but I think he was unable to continue, and asked then that he not be required to act as chairman of this meeting, and further, he felt that in view of the position that his own company had put him in, that he resign as chairman of the Negotiating Committee.

I then acted as chairman of the Employer meeting on the morning of March 27th.

Q. Will you tell us what took place at that meeting?

(Testimony of Frederick L. Miller.)

A. At that meeting, I explained to the assembled employers what had taken place with reference to General Printing and Western Lithograph and the Union. I read to them the terms of [178] the memorandum which Frank Miller had provided the other members of the Negotiating Committee, advised them that those would be the terms upon which the Union would be willing to settle the strike.

We had discussed the matter in committee, and at that time it was the Committee's feeling that under the circumstances, due to those defects, it would be inadvisable to continue the strike, and there was a recommendation made by the Negotiating Committee to the several employers that the strike be terminated.

We also made known to the Committee—rather, the Committee made known to the Employers—that the only basis upon which the strike could be settled, apparently, were on the terms negotiated by General and Western with the Union, and we asked the Employers to ratify in advance those terms as the basis of a proposal which we would offer the Union when we met with them at approximately 12 or 1:00 o'clock that same day.

This was done.

At that meeting I announced to the group—this had also been discussed in committee——

Q. At that meeting you are referring to, the meeting of the morning of the 27th?

A. That is right.

(Testimony of Frederick L. Miller.)

I announced to the employer group — this had been discussed in the Negotiating Committee prior to that—the matter of permitting revocations of these authorizations. I had discussed [179] this matter with an attorney as to whether the authorization with its final paragraph could be moved as to its final paragraph, between the Union Employers Section and those companies wishing to revoke.

We then notified the group that any employers wishing to revoke the authorization prior to the signing of the contract could do so at that meeting.

Q. Did any companies avail themselves of this opportunity?

A. Two companies signed a statement that they were revoking the authorization given the Union Employers Section.

Q. Those companies were what companies?

A. Culver Citizen and——

Mr. Grodsky: Anderson?

The Witness: Anderson Litho.

Q. (By Mr. Doesburg): Did any other companies indicate to you or the Committee an intention to revoke?

A. Yes—at that meeting—after the meeting had concluded, yes, Jeffries Banknote then discussed their situation with the Negotiating Committee.

Q. What was their situation?

A. Mr. Magor represented them, and Mr. Magor indicated that the company would go along on a contract which did not contain the profit-sharing clause which was in the memorandum furnished the

(Testimony of Frederick L. Miller.)

Employer Negotiating Committee by Mr. Frank Miller; if the profit-sharing clause was to be a part of this agreement, [180] Jeffries Banknotes would not be a part to it, and he so stated to Mr. Laidlaw and to other—in fact, there were three or four men in the Negotiating Committee discussing this situation with Jeffries. It was made clear to us by Mr. Magor that this was the position of Jeffries.

Q. What was the next thing that transpired?

A. The meeting then adjourned, and very shortly after, the Union Negotiation Committee appeared at the PIA Building, and we then sat opposite each other at the table. A number of questions were asked about this private understanding or agreement that had been reached by the Union and these two companies, and Mr. Brandt, speaking for the Union Committee, said he had information to offer as to that part, that he was expecting a proposal from the employers, so we finally submitted to Mr. Brandt a proposal identical with the one set forth in the memorandum Mr. Miller had given us the night before.

At that same meeting with the Union before we —as I recollect—before we—well, I can't be sure about the sequence of events, but the Union was notified that with reference to the Culver Citizen, this company had revoked its authorization, and was no longer being represented by the Employers Committee. The Union was also notified as to the position that Jeffries had taken with reference to their negotiation.

(Testimony of Frederick L. Miller.)

Mr. Douglas Laidlaw informed Mr. Brandt and [181] the Union Committee that the company would go along on a contract provided the profit-sharing clause was removed from that contract. If, however, the Union insisted upon the inclusion of the profit-sharing clause, Jeffries would revoke the authorization and this Employers Committee would no longer represent them.

Q. What did Mr. Brandt say when so advised?

A. With reference to Jeffries, he said nothing. With reference to Culver Citizen, he said it made no difference because there was only one employee at that place. I repeated it in different words to Mr. Brandt what Mr. Laidlaw had said with reference to Jeffries because I felt there should be no misunderstanding about Jeffries' position in the negotiation, and I so informed the Union.

Q. Did Mr. Brandt at any time during that meeting or thereafter in your presence make any statement to the effect that Jeffries was covered by the agreement which was arrived at including the profit-sharing clause?

A. No such statement was made.

Q. Proceed.

A. The Union took the proposal that we had submitted to them, left to attend a membership meeting which was being held shortly after we had concluded our meeting with them, and we were notified later that the proposal we had submitted to them had been ratified.

(Testimony of Frederick L. Miller.)

Q. Following the acceptance of the proposal which you had [182] submitted, was an agreement prepared?

A. Yes, Mr. Brandt prepared a draft of the new agreement which he brought to the PIA one afternoon.

Q. I show you General Counsel's Exhibit No. 5, and ask if that is the document to which you refer?

A. This is the document.

Q. When was that document prepared with reference to this meeting of the 27th?

A. Well, this document was prepared subsequent to the meeting of the 27th, prepared after the ratification of both parties. It was brought to the offices of the PIA. I do not remember the date, but I should say just a few days after the 27th.

Q. By whom did you say it was prepared?

A. By the Union.

Q. Copies were delivered to the PIA office?

A. No, Mr. Brandt brought up a copy of this revised agreement and presented it to me for purposes of reading. We made two corrections on this agreement which were embodies in the supplement, and then I noticed that in preparing the agreement that Mr. Brandt had followed the form that had existed in the 1956 contract, which stated the agreement was between the Lithographers Group of Los Angeles and the Amalgamated Lithographers Union of America, Local 22. In this letter which I sub-

(Testimony of Frederick L. Miller.)

mitted to Mr. Brandt on September 17th, that letter stated that the Union Employers Section had been designated as the [183] bargaining agents, and that the Employers Negotiating Committee was empowered to execute a contract with the Union binding on all the companies that we represented, which would eliminate the need for signing individual contracts with employers.

This matter was never discussed in negotiations at any time, and due to the subsequent developments it never occurred to me to raise this matter in negotiations with the Union. Consequently, the submission, then, of this agreement as it was presented to me that afternoon did not refer to the Union Employers Section, and was the same contract that would be signed by each of the houses individually upon the conclusion of negotiations.

I then inquired of Mr. Brandt if he wanted to make this agreement out in the name of the Employers Section for and on behalf of those we represented, or if he wished to execute individual contracts.

Mr. Brandt replied that he wished to have individual contracts, and there the discussion terminated. Mr. Brandt mimeographed the contracts and mailed them.

Q. Mailed them to the individual——

A. To the individual employers. [184]

* * * * *

(Testimony of Frederick L. Miller.)

Cross Examination * * * * *

Q. (By Mr. Grodsky): You are familiar with the authorization form that was signed by Anderson when he authorized the Association to represent the firm. Is that the same form of authorization used by all of the employers? A. Yes.

Mr. Grodsky: No further questions.

Trial Examiner: Did I correctly understand you to testify that you received a memoranda of the strike settlement agreement entered into by General and Western?

The Witness: Yes, sir.

Trial Examiner: Do you have that? [187]

The Witness: I do.

Trial Examiner: Will you produce it, please?

The Witness: Yes, sir.

Trial Examiner: This will be marked Trial Examiner's Exhibit 1 for identification, as of this date.

(Thereupon the document above referred to was marked Trial Examiner's Exhibit No. 1 for identification.) [188]

[See page 175.]

* * * * *

DOUGLAS McNEIL LAIDLAW

a witness called by and on behalf of the respondents, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Doesburg): Are you or have you been a member of the Negotiating Committee of the Printing Industries Association in the Union Employers Section? A. Yes.

Q. Were you present at a meeting on the morning of March 27, 1958, at the offices of the Printing Industries Association? A. Yes, I was.

Q. Will you tell us what took place?

A. The whole morning?

Q. Correct.

A. We had had a meeting of the lithographic employers whom we represented. It was held in the PIA Building, and at that time we presented to the employers group information that we had [189] received the night before from a man with Western Lithograph Company. [190]

* * * * *

Q. (By Mr. Doesburg): Will you tell us roughly what was in the memorandum? [191]

A. It was roughly a memorandum of the contract settlement which we were told by the representative from Western Lithograph Company had been agreed to between the Union and Western Lithograph Company and General Printing and Lithograph Company.

(Testimony of Douglas McNeil Laidlaw.)

Q. What was that man's name?

A. Frank Miller.

Q. Is he an official with Western or General?

A. He is vice president in charge of manufacturing of Western Lithograph Company.

Q. Then, what took place?

A. When we went there, the Negotiating Committee met there ahead of time before the employers arrived, and Mr. Miller at that time said that he had thought it over from the night before and wanted to resign as chairman of our committee, and we talked it over and decided, to take his place we should have Mr. Fred Miller of the Printing Industries Association, to act as chairman of the Committee from that point on out.

Then, when the people arrived, the people that we represented arrived, Mr. Miller presented to them exactly what had happened, and each of the others of us——

Q. How did he do that? How did he present it?

A. He gave a brief little resume of what had taken place the night before, as to the way we had called a meeting among ourselves, where we had met, what had been discussed, and then, I believe, read that memorandum out loud to the gathering there. [192]

Q. Then what took place?

A. Well, the roof practically came off the place. Everybody had a few words to say from that point on out. A great many people stood up and made comments of one sort or another, and it simmered

(Testimony of Douglas McNeil Laidlaw.)

down to the fact that we had informed the Union that we would meet with them as soon as our own meeting was over, we had called Mr. Brandt and told him that, and I believe we had set a tentative time, and I said that I would call him after we had concluded our meeting and tell him what time and place we could meet with them.

Q. Were there any conversations relative to the withdrawal of bargaining authority? A. Yes.

Q. Tell us what that was.

A. Mr. Fred Miller stated that—to all the employers there—that we had had a discussion among ourselves, and felt that at this point, in view of the circumstances then existing that we had agreed among ourselves that anybody whom we represented was then at liberty to withdraw that authorization to us to represent them.

Q. Did anybody so withdraw? A. Yes.

Q. Who were they?

A. Let's see: An outfit called the Culver Citizen [193] or something like that, the Jeffries Banknote Company said they would like to talk to us about it, and a little later on, they did talk to us, and another one, the Anderson Lithograph Company.

In fact, I do not remember the time exactly when he said he was withdrawing himself from signing this thing, and also withdrawing the authorization of the Committee to represent him, and the people from Jeffries talked to us, and said that—as clearly as I can remember it—they said they would go

(Testimony of Douglas McNeil Laidlaw.)

along with the contract provided this pension thing was not a part of it.

The Union had made an additional demand of participation in any pension or profit-sharing plan at the time that we first represented Jeffries, they made this demand of profit-sharing clause, and the Jeffries people said they would withdraw if that were going to be a part of it.

Q. Following this meeting, when was the next thing that transpired?

A. I called Mr. Brandt and told him that we could go ahead then and meet with him as soon as it was convenient with them. He said that he had his committee standing by, that they were ready to meet with us then, and would be over in a matter of a half an hour.

Q. Was such a meeting held? A. Yes.

Q. What took place at such a meeting? [194]

A. Mr. Fred Miller presented this memorandum to Mr. Brandt, either read from it, or handed it to him, and mentioned that it was his understanding that this was what the Union would be willing to settle for, and Mr. Brandt side-stepped that; apparently didn't want to say yes or no on it. He really made no commitment, and said, "You must have a proposal, go ahead and make it." Then Mr. Miller read from that proposal.

Q. You are referring now to the memorandum you previously described?

A. Yes. He read from that verbatim, and Mr. Brandt and a couple of members of his committee

(Testimony of Douglas McNeil Laidlaw.)

copied it down in longhand as it was read to them.

Q. And then what transpired?

A. Then Mr. Miller said there had been some people—he explained what had happened at our own meeting, he went in to quite great detail about the people we represented; he said that some of the people had withdrawn and gave them the names at that time. Mr. Miller asked me if I would tell Mr. Brandt the situation in regard to the Jeffries Banknote Company.

Q. What did you say?

A. I told Mr. Brandt that he could have a contract with the Jeffries Banknote Company if he would remove the profit-sharing clause from his proposal, and he said that he would not do it, and I reiterated it, said, "This is it; I am not kidding; this is what will take place. You can have a contract with the [195] profit-sharing clause out; you will have a contract with the Jeffries Banknote Company. With it in, you will not have a contract."

Q. What did he say?

A. He said something to the effect that—this is not a direct quotation—but it was something to the effect that he could not trust what the Jeffries Banknote Company would do, whether they would follow up this promise and so on, and I said something to the effect that they had assured me that it was the truth, and I had every reason to believe that it was, and he said he doubted that it was the truth; that they would not follow up if he agreed

(Testimony of Douglas McNeil Laidlaw.)

to it, and he said, "We will just have to leave it so they will have to deal with us or we will deal with them," something like that.

Q. Was anything further said or done at that meeting?

A. Yes, we went back over this memorandum which by this time had become a proposal from us, rather than a proposal from them, and we went over that at great length and hashed things out and read them over and over and over, and checked wording and amounts of money, and then we got up to the point where Mr. Brandt said, "They must be playing organ music over at our hall, we had better get under way. This minor language can be settled later, and I will talk to Mr. Miller about it."

Q. Did Mr. Brandt say to you at any time, alone or in your presence, that this agreement covered the Jeffries Company [196] insofar as he was concerned?

A. I don't think I understand the question.

Q. Did Mr.—I will show you General Counsel's Exhibit 5 and ask you if you have seen that document before? A. Yes.

Q. Does that roughly incorporate the substance of the memorandum which you have been describing?

A. It incorporates it. There is more to this.

Q. That is right, but it incorporates the memorandum? A. Yes.

Q. Did Mr. Brandt at that meeting make the specific statement that an agreement reached be-

(Testimony of Douglas McNeil Laidlaw.)

tween your Negotiating Committee and the Union would be applicable to the Jeffries Company?

A. I don't recall anything like that, because he said something to the effect that he would deal with them, something like that, or they would have to deal with him, "They will answer for that," something along those lines. [197]

* * * * *

LESTER BENNETT

a witness called by and on behalf of the respondents, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * * [198]

Q. (By Mr. Doesburg): By whom are you employed? A. Mission Engraving Company.

Q. For how long have you been so employed?

A. Thirty years.

Q. Is that company a member of the Union Employers Section of PIA? A. Yes.

Q. Do you serve in any capacity in that group?

A. Manager—what group? Beg your pardon; I am speaking about my firm.

Q. No, I meant in the PIA group.

A. I was on the committee, if that is what you mean.

Q. What committee?

A. Negotiating Committee.

(Testimony of Lester Bennett.)

Q. Were you present at a meeting of that Negotiating Committee on March 27th held between that Negotiating Committee and the Union, Amalgamated Lithographers, Local No. 22, committee?

A. I was. [199]

* * * * *

Q. To the best of your recollection, can you recall any member stating whether or not Jeffries was to be a part of this agreement?

A. Well, in the beginning of the meeting, let's put it this way, and I think I am very much correct in this, Ted was very emphatic about the fact that Jeffries was part of the agreement.

Q. What did he say? Then what was he told?

A. Well, I think, using my own thinking, I think that they were. Now, what they were told, what he was told—— [201]

Q. Just tell us what was said, to the best of your recollection.

A. I am absolutely satisfied in my own thinking that there was not any question in the mind of anybody on the Committee that Jeffries was part of the agreement.

Q. Was part of the memorandum agreement that you are discussing? A. That's right.

Q. Was anything said in your presence with regard to whether or not Jeffries would participate in the agreement if a profit-sharing plan were included?

(Testimony of Lester Bennett.)

A. There was some objection as far as Jeffries was concerned, but I am talking about the agreement——

Q. All I want you to do is tell us what was said, if you recall, by either Mr. Miller or Mr. Brandt, in the meeting of the 27th.

A. In the meeting of the 27th, and this meeting that I am talking about, we, as a Negotiating Committee, were negotiating for the Jeffries Banknote Company as well as others. [202]

* * * * *

MARTIN SULLIVAN

a witness called by and on behalf of the Charging Party, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * * [203]

Q. (By Mr. Silverman): Are you a member of Local 22? A. Yes, sir.

Q. Were you a member of the Negotiating Committee which negotiated the last contract?

A. Yes, sir.

Q. Were you present at the negotiating session of March 27th which has been described here by other witnesses? A. Yes, sir.

Q. Will you tell us everything that you can remember that was said with respect to Jeffries Bank note at that meeting?

(Testimony of Martin Sullivan.)

A. Since Mr. Brandt's habit of losing his temper is common knowledge, I can explain close to the exact words that he used when the matter of Jeffries Banknote was brought up. I don't know which of the gentlemen from the other committee brought up the name of Jeffries, but Mr. Brandt said——

Q. Can you remember at this point what was said with respect to Jeffries Banknote?

A. They intimated that Jeffries, if the pension plan deal was in the contract, that he did not want a part of it. Mr. Brandt then said, "He is making a sucker out of all you guys. He is happy to be on the Committee when things are going right for him, but when things are going wrong for him, then he wants out, and no matter what happens, the pension plan stays in, [204] and he is a part of the agreement as far as we are concerned."

* * * * *

HENRY LEAMON

a witness called by and on behalf of the Charging Party, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Silverman): Are you a member of Local 22? A. I am.

Q. Are you a member of the Negotiating Committee that negotiated the recent contract?

A. Right.

(Testimony of Henry Leamon.)

Q. Were you present at the negotiating session of March 27th? A. I was.

Q. Would you tell us what was said by the Employers first with respect to Jeffries Banknote?

A. I cannot repeat word for word, but it was to the effect that if the profit-sharing clause was kept in the contract, that the Jeffries Banknote would not be part of it.

Q. What was said by the Union's committee, any member of it, with respect to that?

A. It was said that the profit-sharing clause was written into the contract for the benefit of members, and that it was going to stay, and if the Jeffries Banknote wanted to back out of the agreement, then it would be taken up between Jeffries Banknote and the Union.

Q. Who made that statement?

A. I believe it was made by our spokesman, Mr. Ted Brandt, President.

Q. Did Mr. Brandt say anything else—let me ask you this: Were you in the hearing room when Mr. Sullivan just testified? A. In this room?

Q. Yes. A. Yes.

Q. Did you hear what he said? A. Yes.

Q. Do you recall anything being said at the meeting similar in substance to what he testified?

A. Well, he cut it short.

Q. You fill it in.

(Testimony of Henry Leamon.)

A. If it was repeated word for word, why, it would be a [206] little larger, but if I may just open up a little bit——

Q. Let me ask you first: Do you agree that his testimony fairly represented at least part of what was said at that meeting—— A. Yes.

Q. ——by Mr. Brandt? A. Yes.

Q. It is your testimony that more was said than that? A. Correct.

Q. Would you please add whatever you recollect that you think Mr. Sullivan left out?

A. The words just don't come to me; I will be honest to you.

Q. In sum and substance, your best recollection of what took place.

A. On the dealings that we had had—Mr. Brandt and me, the Union officials had had with Jeffries Banknote on other occasions, it seemed that he was in one time and out the next time when it was to his advantage, and if the picture looked right for him, he was having the Committee negotiate for him, and if it didn't look right, he wanted to stay off of it.

Q. Anything you can add to that?

A. The only thing I can add to that is that on the Committee everyone was very much surprised when Jeffries Banknote assigned themselves to the Printing Industries Committee to be negotiating for them, because they had always been so independent.

* * * * * [207]

ARTHUR J. MOODY

a witness called by and on behalf of the Charging Party, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Silverman): Mr. Moody, are you a member of Local 22? A. I am.

Q. Were you a member of the Negotiating Committee that negotiated the last contract?

A. I was.

Q. Were you present at the negotiating session of March 27th? A. I was.

Q. Will you tell us what you recall the Employers said about Jeffries Banknote at that meeting?

A. Well, my testimony is along the same lines as Mr. Sullivan. This Jeffries Banknote question came in before the two committees, and it was stated very emphatically by Mr. Brandt——

Q. First, what did the Employers say, if you recall? [208]

A. The Employers merely stated that Jeffries would sign this contract if this clause wasn't included, and at that time, Mr. Brandt emphatically told the Employers Committee that he had no prior indication that Jeffries was not still a member of the organization, the Printing Industries Association or the employers organization, and that as

(Testimony of Arthur J. Moody.)

far as Jeffries Banknote was concerned, in his dealings with us, we felt that he was still a member of the Association, and there was no doubt about in our mind about that, and any contract that was signed we would consider Jeffries Banknote a part of.

Q. Mr. Brandt said that?

A. Yes, very emphatically.

Mr. Silverman: I have no further questions.

Cross Examination

* * * * * [209]

Q. (By Mr. Doesburg): What was your conversation with Mr. Brandt?

A. I don't recall my whole conversation. Ted merely stated that to me the Association was trying to bring out the point that they did not know that Ted did no realize, or that our committee did not realize that Mr. Jeffries had withdrawn from the Association, and, as I say, during the last negotiating committee, Mr. Brandt made it very clear to the members of both committees that we would have no part of a different contract than the one we were negotiating, and that included——

Q. In other words, Mr. Brandt indicated that any contract he entered into with Mr. Jeffries had to be the same contract that you negotiated with the Committee? A. That's correct. [210]

* * * * *

GENERAL COUNSEL'S EXHIBIT No. 2

Union Employers Section

Printing Industries Association, Inc. of Los Angeles

1434 West Twelfth Street

Los Angeles 15, Calif.

RIchmond 7-5521

Authorization

The undersigned ..... authorizes the Union Employers Section, Printing Industries Association, Inc. of Los Angeles (referred to herein as "the Association"), to act as its collective bargaining agent in negotiating with the Amalgamated Lithographers Union, Local 22, (referred to herein as "the Union"), a tentative agreement covering wages, hours and other conditions of employment.

If the Association reaches such tentative agreement, it shall be referred to a meeting of those companies signing this authorization, and in the event a majority of said companies attending this meeting ratify its terms, the Association shall then execute a formal contract with the Union binding upon each company signing this authorization.

It is further agreed by the undersigned .... that it will refrain from entering into any individual negotiation, contract, or understanding with the Union, and that it will comport itself

General Counsel's Exhibit No. 2—(Continued)

in a manner consistent with preserving Association unity.

In the event the Association is unable to reach an understanding or tentative agreement with the Union, and said Union takes action against one or more companies, said action shall be considered as an action against all companies.

This authorization may be revoked after the execution of a contract between the Association and the Union by submission of written notice to the Union Employers Section, 1434 W. 12th Street, Los Angeles, California.

.....

Company

By: .....

This firm has .... employees working under the jurisdiction of Lithographers Union, Local No. 22.

Admitted in Evidence August 11, 1958.

GENERAL COUNSEL'S EXHIBIT No. 3

Law Offices
Latham & Watkins

Suite 630
Statler Center
Los Angeles 17, California
MAdison 6-0151

March 13, 1958

Mr. Theodore Brandt
Lithographers Union, Local 22
1220 South Maple Avenue
Los Angeles, California

Dear Mr. Brandt:

As you have been advised, the Union Employers Section, Printing Industries Association represents a number of employers in negotiations with Local 22. As attorneys for and on behalf of the Union Employers Section we wish to advise you that employer authorizations to it are irrevocable by any employer until after the Union Employers Section has concluded a collective bargaining agreement with the Local 22. Also under the authorization the employer binds himself to "refrain from entering into any individual negotiation, contract, or understanding with the Union."

We have been advised that the Union is making individual solicitations of the employers so represented. We hereby put you on notice that the Union

General Counsel's Exhibit No. 3—(Continued)

Employers Section is the exclusive collective bargaining representative for each and all of the employers named and therefore you may not lawfully enter into any negotiation, contract, or understanding with the individual employers, but may only deal through the Union Employers Section. The Union Employers Section and its members will hold you liable for all damages they may suffer if you attempt to negotiate or contract directly with any of the employers it represents. However, it is the hope of the Union Employers Section that you will carefully observe your obligation to deal only with it and thereby make it unnecessary for the Union Employers Section to bring legal proceedings against you for injunctive relief and damages.

Very truly yours,

[Stamped]: NLRB 21st Region Los Angeles 1958 May 15 AM 11:24.

Admitted in Evidence August 11, 1958.

GENERAL COUNSEL'S EXHIBIT No. 4-A

Jeffries Banknote Company
117 Winston Street
Los Angeles 13, California

March 14, 1958

Mr. Theodore Brandt
Local 22
Amalgamated Lithographers Union
1220 South Maple Street
Los Angeles 15, California

Dear Ted:

We have carefully gone over the Union Employers Section's proposal to Amalgamated Lithographers, Local 22, and cannot find anything wrong with it.

I am sure that you feel the same way I do that all of us should do everything within our power to slow down this continuing inflation that we have had since the war.

In view of the fact that the Amalgamated employees have not increased their productivity during the past year, I feel that the Union Employers Section is being more than generous in their offer to Amalgamated. As a consequence, we are left with no other alternative than to refuse the proposed

General Counsel's Exhibit No. 4-A—(Continued)

agreement and join the Union Employers Section as outlined to you in the attached letter.

Kindest regards and best wishes.

Yours very truly,

ALLERTON H. JEFFRIES
President

AHJ:fsl

Admitted in Evidence August 11, 1958.

GENERAL COUNSEL'S EXHIBIT No. 4-B

Jeffries Banknote Company
117 Winston Street
Los Angeles 13, California

March 14, 1958

Local No. 22
Amalgamated Lithographers
1220 South Maple Avenue
Los Angeles 15, Calif.

Gentlemen:

Jeffries Banknote Company has designated the Union Employers Section of Printing Industries Association of Los Angeles as its collective bargaining representative and will henceforth be represented in any negotiations by them.

Yours very truly,

JEFFRIES BANKNOTE COMPANY

ALLERTON H. JEFFRIES
President

AHJ:fsl

[Stamped]: NLRB 21st Region Los Angeles 1958 May 15 AM 11:24.

Admitted in Evidence August 11, 1958.

GENERAL COUNSEL'S EXHIBIT No. 5

[Handwritten]: Master 1958-1960.

AGREEMENT BETWEEN THE LITHOGRAPHERS GROUP OF LOS ANGELES AND AMALGAMATED LITHOGRAPHERS OF AMERICA, LOCAL #22

* * * * *

Section 27. Profit Sharing: It is agreed that any employer having a profit sharing plan covering factory employees will permit but not compel any member of the bargaining unit, who desires, to participate in the said plan.

* * * * *

Section 31. This agreement shall be effective February 15, 1958, and shall terminate March 31, 1960. This agreement may not be altered, modified, or amended in any manner prior to March 31, 1960; provided that the agreement may be opened effective March 31, 1960, on sixty (60) days written notice by either party prior to March 31, 1960.

Section 32. In Witness Whereof we have affixed our hands this 9th day of April, 1958.

EMPLOYERS COMMITTEE,

/s/ By LES BENNETT,
/s/ By FRANK A. MILLER,
/s/ By R. N. ORCHARD,
/s/ By DOUGLAS M. LAIDLAW,
/s/ By FRED MILLER.

General Counsel's Exhibit No. 5—(Continued)

AMALGAMATED LITHOGRAPHERS OF AMERICA,
LOCAL #22,

/s/ THEODORE BRANDT,
President,
/s/ EDWARD SOAR,
Secretary,

Recommended by:

/s/ R. P. SLATER,
International Vice President.

[Seal]

Approved:

/s/ GEORGE A. CANARY,
International President.

Date: 5-2-58.

.....
Firm Name

By .....

* * * * *

Admitted in Evidence August 11, 1958.

GENERAL COUNSEL'S EXHIBIT No. 6

(Copy) September 17, 1957

Mr. Theodore Brandt, President
Amalgamated Lithographers Union, No. 22
1220 Maple Avenue
Los Angeles, California

Dear Mr. Brandt:

In conformity with the understanding reached between us, negotiations between the Union Employers Section, for and on behalf of those member lithographic companies whose names appear listed on the attachement hereto, and your Local Union No. 22, shall commence on the evening of September 17, 1957. The initial meeting of the parties will be held at the union office and subsequent meetings will alternate between your office and the PIA office.

It is also understood that at the September 17th meeting mentioned above, the union and management will exchange bargaining proposals.

Members of the Negotiating Committee representing the Union Employers Section are:

John Anderson, Anderson Lithographing Co.
Les Bennett, Mission Engraving Co.
Douglas Laidlaw, L.A. Lithograph Co.
Frank Miller, Western Lithograph Co.
Fred Miller, Union Employers Section
Robert Orchard, Ray Burns, Inc.
Michael Wolf, Cal Litho Plate

The above named persons were duly elected by the contract holders to speak for them, and have

General Counsel's Exhibit No. 6—(Continued)

empowered said Committee at the conclusion of negotiations to execute in the name of the Union Employers Section a collective bargaining agreement binding upon each and every firm it represents.

It is expected that several UES members who have not yet issued authorizations to the Union Employers Section will do so shortly. As soon as these are received, the union will be notified of their names.

Very truly yours,

Fred L. Miller,
Secretary.

FLM/vw

Admitted in Evidence August 11, 1958.

GENERAL COUNSEL'S EXHIBIT No. 9

[Letterhead of Jeffries Banknote Company, 117 Winston Street, Los Angeles 13, California.]

April 1, 1958

Mr. Theodore Brandt
Amalgamated Lithographers of
America, Local #22
1220 South Maple
Los Angeles, California

Dear Ted:

In view of the fact that wage rates for lithographic workers in the City of Los Angeles have

General Counsel's Exhibit No. 9—(Continued)

been negotiated, and will forthwith be placed in effect, and in view of the fact that we have as yet not had the opportunity to start bargaining on a contract covering the lithographic employees of the Jeffries Banknote Company, we propose that the Union acquiesce and agree to the same increase in the base rates of our employees to be effective with the close of the payroll week Friday, April 4, without prejudice to bargaining on all issues of the contract.

If this is agreeable, will you please sign a copy of this letter where your acceptance is indicated and return to the undersigned.

Yours very truly,

JEFFRIES BANKNOTE COMPANY,

Allerton H. Jeffries,
President.

AHJ:fsl

Accepted:

Amalgamated Lithographers of America, Local #22

.....

Admitted in Evidence August 11, 1958.

GENERAL COUNSEL'S EXHIBIT No. 10

(Copy) April 3, 1958

Allerton H. Jeffries, President
Jeffries Banknote Company
117 Winston Street
Los Angeles 13, California

Dear Al:

This is in answer to your letter to me of April 2, 1958.

We are, of course, expecting that the wage increases will be instituted in your plant as of February 15, 1958, in accordance with the negotiations just concluded.

I am puzzled by your statement that you wish to start negotiations with Local #22.

During negotiations with the Printing Industries Association, on behalf of the Lithographic Employers in Los Angeles, you advised Local #22, in writing, that the Association was bargaining for you as well as on behalf of the various other employers.

Accordingly, we must proceed on the assumption that there is no need for further negotiations, and that we may expect from you a signed contract in

General Counsel's Exhibit No. 10—(Continued)
accordance with the terms agreed upon in the general negotiations.

Very truly yours,

Theodore Brandt,
President - Local #22.

TB:em

[Stamped]: NLRB 21st Region Los Angeles 1958 June 19 AM 9:05.

Admitted in Evidence August 11, 1958.

RESPONDENT'S EXHIBIT No. 1

United States of America
Before the National Labor Relations Board

Case No. 21-RC-4362

JEFFRIES BANKNOTE CO., Employer,

and

LOCAL No. 22, AMALGAMATED LITHOGRAPHERS OF AMERICA, AFL-CIO,
Petitioner.

DECISION AND CERTIFICATION OF REPRESENTATIVES

* * * * *

Certification of Representatives

It Is Hereby Certified that Local No. 22, Amalgamated Lithographers of America, AFL-CIO, has

Respondent's Exhibit No. 1—(Continued)

been designated and selected by a majority of the employees of the Employer in the unit hereinabove found appropriate as their representative for the purposes of collective bargaining, and that pursuant to Section 9 (a) of the Act, as amended, the said organization is the exclusive representative of all the employees in such unit for the purposes of collective bargaining with respect to rates of pay, wages, hours of employment, and other conditions of employment.

Dated, Washington, D. C., July 23, 1956.

BOYD LEEDOM, Chairman,
ABE MURDOCK, Member,
IVAR H. PETERSON, Member,
[Seal] National Labor Relations Board.

Admitted in Evidence August 11, 1958.

TRIAL EXAMINER'S EXHIBIT No. 1

LOS ANGELES SETTLEMENT

	1st Year	2nd Year
Journeymen	$7.75 Week	$5.50 Week
Semi-Skilled	$6.25 Week	$4.50 Week
General Workers	$5.00 Week	$4.00 Week

Wages to be on scale.

Welfare Plan—Will remain at $3.00.

Three weeks of vacation for one year, except for a clause reading * * * "Temporary general workers who have worked less than four months shall be entitled to one day's vacation pay for each five weeks of employment during which they have worked not less than 90% of the straight time hours for their shift."

Washington's Birthday in for 1959.

Cost of Living Index—.03c for each point on the index.

Retroactive to February 15, 1958.

Four new classifications.

It is agreed that any employer having a profit sharing plan covering factory employees will permit but not compel any member of the bargaining unit, who desires, to participate in the said plan.

March 26, 1958, 4:15 P. M.

Admitted in Evidence August 12, 1958.

No. 16701

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Patrick F. Quinlivan, Quinlivan & Thomas, Milton S. Zimmerman and Zimmerman, Healy & Healy,

Appellants,

vs.

Bertram S. Hayes,

Appellee.

APPELLANTS' OPENING BRIEF.

Irving A. Rae,
120 Linden Avenue,
Long Beach 2, California,
Attorney for Appellants,
Millard S. Zimmerman and
Zimmerman, Healy & Healy.

J. C. Sparkes,
1201 Title Insurance Bldg.,
433 South Spring Street,
Los Angeles 13, California,
Attorney for Appellants,
Patrick F. Quinlivan and
Quinlivan & Thomas.

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No. 16701

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

FRANCIS F. QUITTNER, QUITTNER & STUTMAN, MILFORD S. ZIMMERMAN and ZIMMERMAN, KELLY & THODY,

Appellants,

vs.

BERTRAM S. HARRIS,

Appellee.

APPELLANTS' OPENING BRIEF.

This is an appeal from orders of the District Court (1) reversing an order of a Referee in Bankruptcy which allowed attorneys' fees to appellants as special counsel for the Receiver and (2) denying appellants' motion for rehearing and reconsideration of the said order denying attorneys' fees.

I.
JURISDICTIONAL STATEMENT.

The order of the District Court denying appellants all fees as special counsel for the Receiver was entered March 31, 1959 [R. 82-103]. The motion for rehearing and reconsideration of said order, filed April 10, 1959 [R. 104-122] within the ten-day period provided by F. R. C. P. Rule 59 (c), was denied by order entered

August 11, 1959 [R. 152-161]. Notice of appeal was filed August 21, 1959, within the 30-day period provided by Bankruptcy Act Sec. 25, 11 U. S. C. Sec. 48, and F. R. C. P. Rule 73(a), for appeals from the orders made.

The District Court had jurisdiction to review the order of the Referee in Bankruptcy under Bankruptcy Act, Sec. 39c, 11 U. S. C., Sec. 67(c).

This court has jurisdiction to review the order of the District Court under Bankruptcy Act Sec. 24, 11 U. S. C. Sec. 47, and 28 U. S. C. Sec. 1291.

II.
STATEMENT OF THE CASE.

The questions involved on this appeal and the manner in which they are raised are as follows:

1. Were appellants denied due process of law by the Court on the Petition for Review in raising and deciding *sua sponte* a new issue injected into the case by the Court after the submission of the case for decision, of which issue appellants had no notice or knowledge and were not afforded an opportunity of meeting?

2. Did the Court err in denying appellants' Petition for Rehearing and Reconsideration made upon the grounds, among others, that they had no notice of or opportunity to be heard upon the issue raised and decided by the Court *sua sponte* which resulted in the denial to appellants of any attorneys' fees whatsoever and in refusing to request the Referee, whom the Court found had been allegedly deceived, to file a supplemental certifi-

cate setting forth the facts known to and considered by him in passing upon the Petition for Fees?

3. Did the Court err, in abuse of its discretion, in denying appellants any fees as special counsel and in holding, as a matter of law, that, conceding the true facts to be as shown in the affidavits submitted in support of the Motion for Rehearing, the Petition for Fees misrepresented to or concealed facts from the Referee?

4. Was petitioner on review an aggrieved party insofar as the order allowing fees to appellants was concerned?

5. Was there any issue of conflict of interests before the District Court in view of the fact that the identical issue was *res judicata* by reason of failure of appellee to review an order denying removal of appellants as special counsel made upon the grounds of conflict of interest?

The foregoing questions are raised by reason of the following factual situation:

On June 27, 1955, pursuant to petition duly filed by the Receiver in the Matter of Lottie Baruch, also known as Lottie Barry, Barry Baruch, also known as B. Barry, and Jimmy Yao, doing business as Barry Yao Co., a co-partnership, alleged bankrupt, No. 62,410-WM, appellants were appointed as special counsel for the said Receiver to represent him in a contest of the will of Lottie Barry, filed by Bill Barry, (Barry Baruch), the surviving husband of Lottie Barry (Lottie Baruch),

and then pending in the Superior Court of Los Angeles County, California [R. 17].

Services previously performed by appellant Zimmerman in the will contest and services thereafter performed by appellants therein resulted in a settlement of the will contest and the payment to the Receiver of the alleged bankrupt estate of the sum of $15,000.00.

Prior to their appointment appellants were informed by the Referee that their compensation for services would be contingent upon the successful recovery of money for the bankrupt estate.

Appellants filed a petition for allowance of attorneys' fees on a contingent basis of one-third of the amount so recovered [R. 53-60]. The Referee, after hearing, allowed appellants as attorneys' fees for their services 25% of the amount recovered, to wit, $3,767.00 [R. 66-68].

No objections were made or filed before the Referee to appellants' Fee Petition.

Bertram S. Harris, attorney for the petitioning creditors in the bankruptcy proceeding, filed a petition for allowance to him of $3,000.00 as attorney for the petitioning creditors and an additional $5,000.00 for extraordinary services alleged to have been performed by him for the benefit of the estate [R. 37-53, 60-64]. The Receiver on two separate occasions had petitioned the court for leave to employ Mr. Harris as attorney for the estate, both petitions having been denied by the Referee upon the grounds that Mr. Harris represented interests adverse to the estate [R. 67]. The Referee allowed Mr. Harris and his co-counsel

$1,250.00 as fees for representing the petitioning creditors and intervenors, and additional sums as reimbursement for cost advanced [R. 67].

Following the allowance made by the Referee [R. 66-68], Mr. Harris filed a Petition for Review of the Referee's order [R. 68-77]. This petition asserted that the fees *allowed to Mr. Harris* were wholly unreasonable and grossly disproportionate to the services rendered by him for the benefit of the estate or creditors thereof, and were manifestly disproportionate to the fees allowed special counsel who did but a fraction of the work and services performed by Mr. Harris [R. 72, par. XI]. The Petition, insofar as it involved the allowance of fees to the appellants as special counsel for the Receiver, asserted that the Referee's order was erroneous and unsupported by any substantial evidence because it was made upon the ground that the $15,000.00 obtained from the Estate of Lottie Barry, through competent counsel appointed for the Receiver, was because of the efforts of said special counsel rather than the efforts of Mr. Harris [R. 72, par. C]. The Petition prayed for reversal of the order allowing Mr. Harris $900.00 of the $1,250.00 allowed to him and Mr. Miller, and for reversal of the allowance "to Quittner & Stutman and Zimmerman, Kelly & Thody as special counsel; *that no fees whatever be awarded to them for the reason that all services rendered by them were solely for the benefit of Bill Barry,* a bankrupt herein, and not for the creditors, *inasmuch as they represented adverse interests*; that if any fee should be awarded to them, a fee of $400.00 would be reasonable for the very little work done by them." [R. 77].

Mr. Harris' principal complaint was that he should have been allowed a larger fee than special counsel, appellants herein, were allowed, and the basis of his contention as to the allowance of fees to appellants was that they had represented Bill Barry, an interest adverse to the bankrupt estate. In October, 1955, Mr. Harris had filed a petition on behalf of the Receiver to remove appellants as special counsel on the ground that they represented conflicting interests. The Referee denied this petition, the time to review the order of denial expired, and the determination made by the Referee that appellants did not represent adverse interests was *res judicata* [R. 18-25].

At the hearing on the Petition for Review held April 15, 1958, the court limited the issue to be determined to the single issue purportedly raised by the Petition, viz., whether appellants had represented adverse interests in the will contest.

The court, in so limiting the hearing to this single issue, stated:

> "The Court: *I am not interested,* unless you wish to offer evidence, *as to what services were performed or the reasonable value of them. I am satisfied with the Referee's findings as to those matters but some serious charges were made here by Mr. Harris on the conflict of interest that I feel we should make some inquiry into."* [R. 186].

In opposition to the Petition for Review appellants had contended that Mr. Harris was not a party aggrieved by that portion of the order of the Referee allowing fees to appellants. And appellants, in reliance upon the

above quoted statement of the Court that the sole issue to be determined was whether appellants had or had not represented conflicting interests, proceeded with the hearing upon the assumption that the Court would consider only this issue of conflicting of interest. The hearing proceeded on this assumption even though, as will subsequently appear, that issue had been previously determined by the Referee, was final and *res judicata.*

Thus, the questions stated in 4 and 5 above are raised.

During the hearing before the Court appellant Zimmerman, in relating the background of the will contest chronologically and the problems that arose with respect to the probate homestead, narrated the services performed by him prior to his appointment as special counsel. He testified that meetings had been held by him with the attorneys for the special administrator in an effort to effect a settlement, that the opposing parties first offered a nominal nuisance settlement which was increased to $5,000.00 and resulted in Mr. Zimmerman proposing to opposing counsel that Mr. Barry would accept approximately 15% of the estate as a compromise and, as will later appear, Mr. Zimmerman incorrectly stated that opposing counsel had tentatively agreed to a proposal made by him for the payment of $15,000.00 in settlement of the will contest. He stated further that after appointment of special counsel meetings were held in Mr. Quittner's office, attended by the interested parties, and that eventually a $15,000.00 settlement was agreed upon to settle the will contest [R. 186-199]. As will subsequently appear, the proposal made by Mr. Zimmerman in May

of 1955 was rejected by a counter offer, a new proposal was made by the attorneys for the opposite parties in July, 1955, of a lesser amount, negotiations continued, and finally resulted in a $15,000.00 settlement in December, 1955.

Appellant Quittner [R. 226-229] testified on the charge of conflict in interests and that when special counsel were appointed on June 27, 1955, negotiations for settlement of the will contest were still in the negotiation stage and were not finally agreed upon until approximately six months later.

From the foregoing it is obvious that appellants had no notice or knowledge that there was any issue before the Court on review as to whether they or either of them had misrepresented facts to or concealed facts from the Referee with respect to the services performed by them as special counsel or the value and extent thereof.

However, on March 31, 1959, the District Judge filed a Memorandum of Decision and Order denying appellants any compensation whatsoever for the services rendered by them as special counsel, and instead of remanding the cause to the Referee for further determination, reversed the order allowing fees and denied appellants any fees as special counsel [R. 103].

The opinion of the Court is reported as *In re Barry Yao Co.,* 172 Fed. Supp. 375, and is reproduced in the Record herein, pp. 82-103. The court's ruling is predicated upon the ground that appellants, in petitioning for the allowance of fees, did not fully disclose to the Referee the value and extent of the services rendered by them in the settlement of the will contest controversy. It

is conceded that the issue and grounds of decision of the District Court were not raised by objections before the Referee or in the Petition for Review or at the hearing before the District Court, for the Court in its opinion [R. 85] said, "also to be considered by the court *sua sponte, though not raised by the petitioner*" are the questions whether appellants misrepresented facts to or concealed facts from the Referee in their petitions. Thus the Court, following submission of the case for decision, decided the case upon an issue not previously raised and of which appellants had no notice or knowledge and no opportunity to prepare for hearing or present testimony of witnesses. The questions presented in paragraphs 1, 2 and 3 above were thus raised.

Appellants promptly filed a Motion for Rehearing and Reconsideration. This motion [R. 104], and supporting affidavits [R. 106-122; 127-135; 137-152], asked for a rehearing and reconsideration upon the grounds:

(1) That the court should request the Referee in Bankruptcy to file a supplementary Certificate on Review setting forth the facts as shown to the Referee on the issues considered and decided *sua sponte* by the Court in its decision of March 31, 1959;

(2) That the court should permit appellants to introduce evidence in connection with the issues considered and decided *sua sponte* by the Court;

(3) That the Court should reconsider the findings and conclusions upon the issues considered and decided *sua sponte,* and vacate such of the findings or conclusions which were to the effect that

the appellants made misrepresentations to the Referee in Bankruptcy concerning the value and extent of the services rendered after their employment as special counsel and concerning the contingent basis of the fee petitioned for by them;

(4) That after rehearing and reconsideration, including the supplementary certificate of the Referee and such additional evidence, that the court should amend its findings and conclusions so as to determine that appellants made no misrepresentations to the Referee, and amend its order to affirm the Referee's order allowing fees.

The Court refused to request the Referee who had heard the fee petition, and who was the one allegedly deceived by appellants, to file a supplementary certificate setting forth the facts known to the Referee on the issues not raised in the Petition for Review but raised and decided by the Court *sua sponte,* and denied the Motion for Rehearing and Reconsideration [R. 152-161].

The affidavits filed in support of the Motion for Reconsideration are uncontroverted. They disclose without contradiction that the appellants did not, in the petition for fees, misrepresent to or conceal any facts from the Referee who heard and decided the fee petition.

The testimony of the Referee has been perpetuated by way of deposition taken since the rendition of the order denying rehearing, and this deposition clearly discloses that no misrepresentations were made to the Referee and that he was not deceived or misled as to the nature or value of the services rendered by appellants.

III.
STATEMENT OF UNDISPUTED FACTS.

The following facts are undisputed.

Lottie and Bill Barry were husband and wife. Lottie was possessed of considerable wealth.

Lottie Barry, Bill Barry and Jimmy Yao had executed, and recorded in Los Angeles County, a limited copartnership agreement under the provisions of which Lottie was a limited partner [R. 46-47].

Under California law (Corp. Code, Sec. 15501, *et seq.*) Lottie, as a limited partner, was not liable for the obligations of the partnership.

On August 11, 1954, a creditor of Barry Yao Co., through attorney Bertram S. Harris, filed an involuntary petition in bankruptcy against "Lottie Baruch, also known as Lottie Barry, Barry Baruch, also known as B. Barry, and Jimmy Yao, doing business as Barry Yao Co., a copartnership." [R. 3].

The answer filed by the alleged bankrupts, through the law firm of Quittner & Stutman, contended that Lottie Barry was a limited and not a general partner of Barry Yao Company.

Trial upon the issues raised by the involuntary petition and answer thereto was never had. There was no adjudication of bankruptcy of the limited partnership until April 27, 1956, following the filing of the stipulation hereinafter for settlement on January 10, 1956 [R. 29-36].

The petitioning and intervening creditors, represented by Mr. Harris, despite the limited partnership agree-

ment, contended that Lottie was a general partner of Barry Yao Company. The alleged bankrupts contended that she was a limited partner only. It was the obvious purpose of the petitioning and intervening creditors to attempt to subject Lottie's substantial assets to their claims against the partnership [R. 9-10, par. I; R. 11, par. II; R. 46-47].

Lottie died testate on November 5, 1954. On November 9, 1954, a petition for probate of Lottie's will was filed in the Superior Court of the State of California, in and for the County of Los Angeles, by Union Bank and Trust Company, the executor named in her will.

Hearing on this petition was set for November 29, 1954. On November 24, 1954, Bill Barry, surviving husband of Lottie, represented by the law firm of Zimmerman, Kelly & Thody, filed opposition to the probate of said purported last will of Lottie upon the grounds that she was not of sound and disposing mind and had been subjected to undue influence by one of the principal beneficiaries under the will. This opposition before probate, generally referred to as a contest before probate, is authorized by the provisions of California Probate Code Sections 370-374. The effect of this contest before probate was to prevent the court from admitting Lottie's will to probate and from appointing the bank as executor of the will. The bank was therefore appointed as special administrator of the estate.

The law firm of Scheinman & Scheinman were the attorneys for the bank as special administrator. Attorney Charles J. Katz was the attorney for the principal beneficiary named in Lottie's will and was associate

counsel for the bank as special administrator. Mr. Katz' client was a stranger in blood to the decedent, and it was his client who was alleged to have exercised the undue influence and who would have received nothing had the will contest been successful, and whose distributive share would have been reduced by the sum of over $16,000.00, the amount of the creditor's claims filed against the probate estate, if they were allowed, even if the will contest was unsuccessful.

On December 28, 1954, two surviving sisters of Mrs. Barry, also represented by the law firm of Zimmerman, Kelly & Thody, filed an additional contest before probate.

Receiver Ralph Meyer had taken no steps whatsoever to contest Lottie Barry's will or participate in the will contest instituted by the alleged bankrupt Bill Barry, even though any assets recovered as a result thereof would have inured to the benefit of the bankrupt estate.

Before June 27, 1955, the law firm of Zimmerman, Kelly & Thody made numerous appearances at hearings in the probate court, conducted investigations and participated in the taking of depositions of witnesses.

Before her death, Lottie Barry had executed and recorded a declaration of homestead upon the family residence. This entitled Bill Barry, the surviving spouse, to an exemption under California law in the sum of $12,500.00 (Civ. Code, Secs. 1138, 1260, and 1261).

All legal services performed on behalf of Bill Barry in the will contest before June 27, 1955, were performed

by the law firm of Zimmerman, Kelly & Thody. The law firm of Quittner & Stutman had not participated in any such proceedings whatsoever.

In early June, 1955, Milford Zimmerman of the law firm of Zimmerman, Kelly & Thody, informed attorney Francis F. Quittner, who specialized in bankruptcy law, that he, Mr. Zimmerman, had previously conferred with Norman L. Scheinman, one of the attorneys representing the estate of Charlotte Barry, and that Mr. Sheinman had indicated to Mr. Zimmerman that possibilities existed for the compromise of the will contest. Mr. Quittner informed Mr. Zimmerman that under General Order in Bankruptcy No. 44, it was necessary that Mr. Zimmerman be appointed as special counsel by the bankruptcy court if he expected to receive compensation for his will contest services out of the bankrupt estate. Mr. Zimmerman requested Mr. Quittner to associate with him in the matter [R. 107-108].

Shortly thereafter Mr. Quittner conferred with David B. Head, referee in bankruptcy, to whom the Barry Yao bankruptcy matter had been assigned. Mr. Quittner advised Referee Head fully of the then status of the will contest as he knew it, including the fact that discussions and negotiations pertaining to compromise had already been had between Messrs. Zimmerman and Scheinman. Referee Head stated in substance that he did not believe that the will contest could be successfully concluded in favor of the bankrupt estate, that he would not authorize the expenditure by the receiver of any money for the purpose of prosecuting the will contest, but that *he would be willing to authorize employment*

by the receiver of Zimmerman and Quittner as special counsel but only upon the express understanding that said special counsel would receive no compensation from the bankrupt estate unless the will contest or a compromise thereof actually resulted in a money recovery for the bankrupt estate, and that, contingent upon such recovery, compensation based upon an appropriate percentage of the recovery would be determined and allowed by the referee to special counsel at a date when all applications for compensation were heard. Mr. Quittner at that time informed Refereee Head that substantial services had already been performed by Mr. Zimmerman, that investigations had been made and much work had been done by Mr. Zimmerman in the hope that a satisfactory settlement of the will contest could be negotiated [R. 108-109].

Following the meeting between Referee Head and Mr. Quittner in June, 1955, the Receiver, Ralph Meyer, filed a petition for leave to employ special counsel to represent the interests of the bankrupt estate in the will contest previously filed to the will of Lottie Barry, deceased, by Bill Barry. This petition [R. 11-15] set forth the facts relative to the filing of the will contest and state that in the bankruptcy proceeding Lottie Barry had denied that she was a general partner, that the will contest was at issue, that the principal beneficiaries under the will had filed answers denying that there were grounds of contest, that in the event any beneficial results were obtained as a result of the contest brought by Bill Barry, the bankrupt estate would benefit as Bill Barry's share of his wife's estate would become an asset of the bankrupt estate, that such a contest would be expensive but

that if negotiations were carried on with the special administrator and the beneficiaries, a compromise might be obtained for the benefit of the bankruptcy creditors, and that the Receiver proposed to employ the law firms of Quittner & Stutman and Zimmerman, Kelly & Thody as special counsel for the purpose of either completing the will contest or presenting to the court for its approval any proposed compromise that might be offered by the bank, as special administrator, and the beneficiaries. The Receiver stated that he intended to employ such special counsel because they were fully familiar with the litigation, had made all necessary preparations for its trial, and that he proposed to employ the said special counsel under an agreement whereby said firms would receive as compensation for their services *whatever sum the court allowed from the recoveries made for the benefit of the estate.* The petition was supported by affidavits of the special counsel, required by General Order 44, setting forth their interest in the matter, but also setting forth that in connection with the will contest proceedings the said Bill Barry did not have any interest adverse to the Receiver or the bankruptcy creditors [R. 15-16].

On June 27, 1955, an order was signed by the Referee appointing Quittner & Stutman and Zimmerman, Kelly & Thody as special counsel to represent the Receiver in the will contest.

Before the meeting between Referee Head and Mr. Quittner and before the petition for appointment of special counsel was filed and granted, Mr. Zimmerman, without Mr. Quittner's knowledge, had submitted to Mr. Scheinman, attorney for the executor, an unsigned draft

of a proposal of settlement dated May 11, 1955, proposing to settle the will contest by the payment of $15,000.00 in cash to Bill Barry upon the conditions set forth in said letter. This proposal was not accepted by the attorneys for the executor or the principal beneficiary but was rejected by them by a counter-offer of May 17. This counter-offer was not accepted, and a further proposal was submitted by the attorneys for the executor on July 14, 1955. Thereafter negotiations were conducted until December, 1955, resulting in a final settlement. Thereafter, appellants, Mr. Harris, the trustee, receiver, and his attorneys, each filed separate fee petitions which were heard by the Referee. No objections were filed thereto, and the Referee made a single order allowing fees to the respective petitioners [R. 66-68]. Mr. Harris, being dissatisfied with the amount awarded him, filed a Petition for Review. The District Judge affirmed the fee allowance to Mr. Harris on the ground that he did not represent the Receiver.

At the outset of the Hearing on Review, the court, in response to a statement from Mr. Zimmerman, made the above quoted statement that the court was satisfied with the Referee's findings as to what services were performed by special counsel and the reasonable value thereof and was interested only in the charge made by Mr. Harris of alleged conflict of interests [R. 185-186]. Mr. Zimmerman, in testifying on the conflict of interest issue, reviewed the services performed by him and his firm in the will contest and with respect to the probate homestead matter, the settlement negotiations conducted by him prior and subsequent to his appoint-

ment as special counsel, his lack of knowledge of Mr. Harris' participation therein, and his consultation with Mr. Quittner to handle the bankruptcy aspects of the will contest [R. 186-199].

On cross-examination Mr. Zimmerman testified that his settlement discussions with the executor's attorneys did not include dismissal of the bankruptcy proceedings against Lottie Barry [R. 204-205], that he had no knowledge of any lawsuit that Mr. Harris had pending against the probate estate of Mrs. Barry [R. 207] which was on behalf of four creditors seeking recovery of over $15,000.00 [R. 208]. Mr. Zimmerman referred to correspondence exchanged between him and Mr. Scheinman relative to the settlement [R. 205] and to the fact that upon his appointment as special counsel he would represent the best interests of the Receiver to effect a recovery in the will contest, that he had advised Mr. Barry that any recovery under the will contest would go to the bankrupt estate [R. 210-211], and that there was no conflict of interest because any recovery by virtue of the will contest would go to the Receiver.

Mr. Zimmerman further testified on cross-examination that on May 11, 1955, he wrote Mr. Scheinman, the executor's attorney, a letter proposing a settlement of all of Bill Barry's claims against the Lottie Barry probate estate and the setting aside of the exempt homestead proceeds to Bill Barry [R. 215-217], and that the settlement was finally agreed upon in December, 1955 [R. 217]. Mr. Zimmerman erroneously stated that within a few days after May 11, 1955, he received a telephone call from Mr. Scheinman suggesting decreas-

ing the amount of the probate homestead proposal by $500.00, that it would be necessary for certain claims of Mr. Schwartz to be resolved, but stating that the payment of the $15,000.00 in lieu of the will contest, if it would include the contest filed by Mrs. Barry's two sisters, would be satisfactory to him and he would so recommend [R. 218-219]. Mr. Zimmerman further stated that the actual settlement was made after June 27, 1955, and mistakenly and erroneously stated that substantially all negotiations took place prior to that date but that the amount had been agreed to and there was a tentative determination subject to the approval of both courts [R. 219-220], and further stated erroneously that within a few days after the May 11 offer there was tentatively an agreement between Mr. Scheinman and Mr. Zimmerman that Mr. Scheinman would recommend the $15,000.00 settlement of the will contest so far as he was concerned, and that the matters that happened subsequently with reference thereto, of which Mr. Zimmerman knew, were implementations because Mr. Scheinman could not speak for other people and Mr. Katz' consent had to be obtained, and that what was done in May was to lay the groundwork for further work that was going to be done subsequently [R. 229].

Mr. Quittner had no knowledge until the hearing on the review of the letter of May 11, 1955, submitted by Mr. Zimmerman to Mr. Scheinman or of any reply thereto. Mr. Quittner testified with respect to his views of the only purported issue before the court, viz., the conflict of interest charge [R. 226-227], and that with respect to Mr. Zimmerman's testimony that a settlement was tentatively agreed upon in May, 1955, before

appointment of special counsel, that no settlement had been actually agreed upon but that the matter was still in the negotiation stage, that he conducted many negotiations in his office, and that it was not until six months later that the final settlement figure of $15,000.00 was actually agreed upon [R. 227-229]. In these settlement discussions held after appointment of special counsel, Messrs. Scheinman and Katz, attorneys for the bank and principal beneficiary, flatly informed Mr. Quittner that if they were going to pay anything like $15,000.00 they wanted a clean slate including a complete dismissal of the bankruptcy proceeding against Mrs. Barry's estate, and that they did not wish to be required to try the issue of whether Mrs. Barry was a general partner. Mr. Quittner knew nothing about the lawsuit filed by Mr. Harris on the rejected creditor's claims until it was mentioned at a hearing before Referee Head [R. 227-231].

It seems apparent from a reading of the Opinion of the court denying fees that the court was under the impression that the settlement had been substantially if not fully consummated prior to the appointment of special counsel, for the court raised this question *sua sponte* in its Opinion without notifying appellants that there was any issue involved concerning alleged misrepresentation or concealment and without affording them an opportunity to be heard thereon.

It was not until the receipt of this Opinion of the court, almost a year after the Hearing on Review, that appellants had any notice or knowledge that the court had injected the issue of alleged misrepresentation and concealment into the case. They promptly filed a Mo-

tion for Rehearing and Reconsideration seeking the opportunity of meeting that issue and presenting evidence thereon. This petition was supported by affidavits of appellants and Norman Scheinman. The statements made in these affidavits are undenied and uncontroverted. They are summarized below:

The affidavit of Norman Scheinman [R. 127-130] shows that Mr. Zimmerman's testimony at the hearing relative to the May 11 proposal being tentatively agreed to was erroneous. The Scheinman affidavit conclusively shows that before May 11, 1955, Mr. Zimmerman had orally suggested to Messrs. Scheinman and Katz a settlement of the will contest on certain terms, including the payment to Bill Barry of $15,000.00, but neither Mr. Scheinman nor Mr. Katz indicated that such a proposal would be acceptable to them or their clients. Thereafter Mr. Scheinman received from Milford Zimmerman an unsigned draft of a proposal dated May 11, 1955, which did not provide for the direct payment to the bankruptcy estate of any money whatsoever. It provided for payment *to Bill Barry* of $15,000.00, *a part of which would be utilized to effect a settlement with bankruptcy creditors* insofar as any claim on their part was concerned *as to any interest of Bill Barry in the probate estate. This offer was never accepted.* On May 17, 1955, Mr. Scheinman transmitted to Mr. Zimmerman a suggested letter for Mr. Zimmerman's signature, the terms of which were substantially different from the terms of Zimmerman's offer of May 11, 1955, and constituted a counter offer which rejected the May 11 proposal. In fact, Mr. Scheinman did not have authority from the executor to make a

settlement in accordance with the provisions contained in the offers or proposals of May 11 or May 17 [R. 128]. The affidavit states that no further written communication relative to a settlement was received by Mr. Scheinman from Mr. Zimmerman until December 28, 1955, although between May 17 and December 28 Mr. Scheinman had numerous telephone and personal conversations with Mr. Zimmerman relative to a settlement, none of which resulted in a settlement. Mr. Scheinman further stated that on June 27, 1955, the date that special counsel for the Receiver were appointed, there was no settlement of any of the controversies involved in the Lottie Barry Estate and that Mr. Charles Katz, co-counsel with Mr. Scheinman for said estate, "had not indicated any consent to the proposals which had theretofore been discussed." On July 11, 1955, following the appointment of special counsel for the Receiver, Mr. Scheinman conferred with Mr. Zimmerman, negotiations were resumed, and on July 14, 1955, Mr. Scheinman prepared a written outline of a proposed settlement on terms different from those previously proposed by Mr. Zimmerman on May 11. The Scheinman proposal was to pay only $12,250.00 in settlement of the will contest, and this was to be paid into the bankruptcy estate rather than to Bill Barry as previously proposed by Mr. Zimmerman. There were other conditions contained in the Scheinman offer which were substantially different from those contained in the draft of May 11, 1955, prepared by Mr. Zimmerman [R. 128-129].

The affidavits executed by Mr. Quittner in support of the Motion for Rehearing [R. 106-117; 131-136; 144-

152] disclose, without contradiction, the following: that Mr. Quittner performed no services in connection with the will contest prior to his appointment as special counsel; that before his appointment as special counsel he consulted Referee Head relative to the will contest and made full and complete disclosure to Referee Head of all facts related to Mr. Quittner by Mr. Zimmerman relative to the will contest; that Referee Head was familiar with the will contest and thought that it lacked merit; that Mr. Quittner informed Referee Head that Mr. Zimmerman had prepared and participated in the will contest, had taken depositions, had conducted investigations, and commenced negotiations with the executor's attorney in the hope of settling the will contest; that Mr. Quittner informed the Referee that he was of the view that Mr. Zimmerman's negotiations were not entirely for the benefit of the bankrupt estate in that Mr. Zimmerman hoped to compromise the matter in a manner by which Mr. Barry would personally receive some consideration from the settlement; that he further informed the Referee of the advice he had given to Mr. Zimmerman, that settlement negotiations had not resulted in an agreement, but that Mr. Zimmerman believed that if they were pursued a settlement could be reached, that no offer of settlement had been made to Mr. Zimmerman by the executor, and that Mr. Katz, who represented the principal beneficiaries under the will, was at that time wholly opposed to any settlement because he believed that he could successfully defeat both the bankruptcy proceedings and the will contest as to Mrs. Barry's estate. Referee Head expressed doubt that the will contest could be successfully concluded in

favor of the bankrupt estate but said that if there was a chance of recovery of funds for the bankrupt estate without any expenditure by the receiver that he would recommend the employment of Messrs. Zimmerman and Quittner in the will contest and that it would be for the benefit of the estate to appoint such counsel because of Mr. Zimmerman's familiarity with the will contest from which the bankrupt estate would benefit. The Referee was emphatic in stating that special counsel would be employed wholly on a contingency basis and that they would receive no compensation unless the will contest or a compromise thereof resulted in a money recovery for the bankrupt estate, and that if it did their compensation would be based upon an appropriate percentage of the recovery.

These affidavits also disclose that subsequent to the appointment of special counsel settlement negotiations were conducted over a period of six months and finally resulted in a settlement. They show that the estimate of 160 hours devoted to the settlement by both special counsel was an estimate of the number of hours spent subsequent to their appointment as special counsel; that since they had been advised that they would be paid solely on a contingent fee basis, and so stated in the Fee Petition [R. 59, par. X], the background information contained in the Fee Petition, and with which the Referee was thoroughly familiar, was not intended to state or imply that the services there performed were performed after appointment of special counsel; and that the Referee was not misled or deceived thereby. These affidavits of Mr. Quittner further disclose that it was Mr. Quittner's understanding that there was no

issue before the Referee or the Court on the review as to whether he or Mr. Zimmerman had made representations to or concealed facts from the Referee concerning the value and extent of the services rendered by them; that it was his understanding based upon the statement of the Court that the only issue in which the Court was interested was the contention that special counsel represented conflicting interests; that Mr. Quittner since the making of the order denying fees had reviewed his files, had consulted Referee Head and Messrs. Scheinman and Katz, and had ascertained that the tentative proposal made May 11 by Mr. Zimmerman had been rejected before appointment of special counsel [R. 131-136]; that he frequently informed Referee Head as to the status of the settlement negotiations and made no misrepresentations to the Referee or the Court; and that as a result of his conferences with Referee Head he believed that if the Court would request Referee Head to file a supplemental certificate setting forth the facts known to the Referee on the issues raised and decided *sua sponte* by the Court that it would appear that the Referee was fully advised as to the status of the settlement negotiations as of the date of employment of special counsel and as to the other facts reported to Referee Head by Mr. Quittner [R. 106-114].

The affidavits of Mr. Zimmerman [R. 117-122; 137-144] disclose that he was in error in his statements made in Court on the review relative to the May 11 proposal of settlement; that instead of being accepted, tentatively or otherwise, that proposal was rejected by Mr. Scheinman; and that it was not until after appointment of special counsel that settlement negotiations were

resumed and finally consummated in December after numerous conferences between all interested parties. These affidavits further show that neither Mr. Zimmerman nor Mr. Quittner kept full or complete time records of the time devoted to this matter because it was a contingent fee matter where they customarily did not keep such records, and that the estimate of 160 hours of time was for time spent subsequent to appointment of special counsel.

Despite this uncontradicted showing that no facts were concealed from or misrepresented to the Referee, the Court denied the Motion for Rehearing and Reconsideration.

IV.

SPECIFICATION OF ERRORS.

1. The Court erred by raising and deciding *sua sponte* in its order of March 31, 1959, issues not specified in the Petition for Review or raised at the hearing thereon, without giving fair notice to appellants that said new matters and new issues were to be considered by the Court, and without affording appellants an opportunity to be heard thereon.

2. The Court erred by its order of March 31, 1959, which reversed the order of the Referee in Bankruptcy allowing fees to appellants as special counsel for the Receiver and denied appellants any fees whatsoever.

3. The Court erred in its order of August 11, 1959, in denying appellants' Motion for Rehearing and Reconsideration.

4. The Court erred in denying appellants' Motion requesting the court to direct the Referee in Bankruptcy to file a supplemental certificate on review setting forth the Referee's knowledge of the facts and issues considered and decided by the Court *sua sponte*.

V.
ARGUMENT.

1. It Was Error for the Court to Deny Attorneys' Fees to Appellants Upon Grounds Not Raised Before the Referee, or in the Petition for Review and Which Were Excluded From Consideration by the Court at the Hearing Thereon.

Two reputable members of the Bar, appellants herein, without notice or an opportunity to be heard, have been branded by a district judge as guilty of misrepresenting to and concealing material facts and information from a referee in bankruptcy.

This is not the first time that district judges have, without notice or an opportunity to be heard, taken summary action against members of the Bar. This Court has promptly reversed such orders upon the ground that the district judge had denied due process of law to attorneys by summarily disciplining them in the course of proceedings dealing with other matters where the judge gave no prior notice to the attorney that his right to practice law was in issue. (*Matter of Los Angeles County Pioneer Society,* 217 F. 2d 190 [9 Cir., 1954]; *United States v. Hicks,* 37 F. 2d 289 [9 Cir., 1930]).

These Court decisions are not limited to disciplinary cases but apply to a variety of cases.

In *Parker v. Lester,* 227 F. 2d 708 (9 Cir., 1955), this Court applied the holding of the *Los Angeles County Pioneer Society* case, *supra,* to that of a seaman who was held to have been denied due process of law by the Coast Guard officials.

The principle that every person is entitled to due process of law and that a denial thereof requires reversal has been applied in numerous cases and under a variety of situations.

The essential elements of due process of law are (1) notice and (2) an opportunity to be heard and to defend (3) in an orderly proceeding adapted to the nature of the case before a tribunal having jurisdiction of the cause. See authorities collected in 12 American Jurisprudence, p. 267, Sec. 573.

As stated in *W. J. R. The Goodwill Station v. Federal Communications Commission,* 174 F. 2d 226, at 235 (D. C. Cir., 1948), there are at least three essential elements to due process, (1) the right to seasonably know the charges or claims preferred, (2) the right to meet such charges or claims by competent evidence, and (3) the right to be heard by counsel upon the probative force of the evidence produced by both sides and upon the law applicable thereto. If any of these rights be denied a party he is denied due process.

In the case of *Morgan v. United States,* 304 U. S. 1, 18, 82 L. Ed. 1129, 1132 (1937), the Supreme Court said:

> "The right to a hearing embraces not only *the right to present evidence but also a reasonable opportunity to know the claims of the opposing party and to meet them.* The right to submit argument implies that opportunity; otherwise the right may be but a barren one. Those who are brought into contest with the Government in a quasi-judicial proceeding aimed at the control of their activities *are entitled to be fairly advised of what the Government proposes and to be heard upon its proposals before it issues its final command.*
>
> "No such reasonable opportunity was accorded appellants." (Emphasis added.)

This language of the Supreme Court is applicable in the present case.

Here, appellants filed with the Referee in Bankruptcy a petition for fees for services rendered by them as special counsel for the Receiver. They requested one-third of the amount of the recovery effected by them for the bankrupt estate. No objections were filed to this petition. The Referee, after hearing and having full knowledge of all of the facts both as disclosed by the petition for fees, the file in the case and information furnished to him by one of the appellants during the progress of the bankruptcy proceedings, granted appellants one-fourth rather than one-third of the amount of the recovery. In allowing these fees the Referee stated *"In the matter in which the estate recovered* $15,000.00 *from the Estate of Mrs. Barry, the receiver-trustee was represented by competent special counsel"* [R. 67].

The Petition for Review did not raise any issue that the appellants or either of them had misrepresented to or concealed facts from the Referee. The Court at the outset of the hearing stated that he was satisfied with the Referee's allowance of fees to appellants and that the only issue that he was interested in was the alleged conflict of interest. Appellants proceeded with the hearing upon the assumption that the latter was the only issue before the Court, and the cause was submitted for decision on that basis. The Court thereafter raised and decided *sua sponte* an entirely new issue of which appellants had no prior notice, and were not afforded the right to meet the new issue by competent evidence or to be heard by counsel upon the evidence and the law applicable thereto. All three elements essential to due process were lacking, and this constituted a denial of due process of law.

The following additional authorities are in point:

In *Sheets v. Livy,* 97 F. 2d 674 (4 Cir., 1938), the Court relied upon the *Morgan* case, *supra,* and held that

there was a denial of due process of law in a bankruptcy proceeding. In that case the debtor farmer filed a petition under 11 U. S. C. A., Sec. 203(s) for an extension or composition. Under the statute it is a condition precedent that the offer of the debtor be made in good faith. The farmer debtor's offer was rejected and the rejection reported to the district court. The farmer debtor then filed an amended petition. The Commissioner's report indicated that the offer had not been made in good faith, but the Commissioner had made no finding on that issue. The district judge, without hearing, dismissed the amended petition on the ground that the offer had not been made in good faith. The Court of Appeals agreed with the District Court's conclusion but reversed the case upon the ground that there had been a denial of due process in failing to notify the farmer debtor that there was an issue of good faith involved and in not affording him an opportunity to be heard thereon. At page 675, the Court said:

> *"It was improper, no matter how strong the evidence of lack of good faith, to take this action without notice to the debtor and opportunity to be heard . . . the case was dismissed by the District Judge in a decree based upon an opinion in which for the first time the issue of good faith was decided.* We are of the opinion that the dismissal of the proceedings in this matter *amounted to a denial of due process."* (Emphasis added.)

In *Beaver Valley Water Co. v. Driscoll* (23 Fed. Supp. 795 (D. C. W. D. Penn., 1938), a rate hearing case, the Court, in reliance upon the *Morgan* case, *supra,* held that there was a denial of due process. There, the

hearing examiner, after taking evidence, informed the Company that it had better put in the rest of the evidence because the Commission was considering making a temporary order against the Company. A continuance for the purpose of doing this was requested, and the case was continued to a date certain. The hearing was then cancelled by the Commission, and the order was made. This was held to be a denial of due process.

In *Takeo Tadano v. Manney,* 160 F. 2d 665 (9 Cir., 1947), a habeas corpus deportation case, this Court, relying upon the *Morgan* case, *supra,* held there was a denial of due process. There the petitioner, a Japanese alien, had been picked up on a warrant for arrest of alien and a hearing was had. At the hearing the question was whether the alien had carried on a trade in which case he would be entitled to an exemption and would not be subject to deportation. No other issue of fact was raised. The hearing officer erroneously applied an amendment to the law which required the alien to carry on trade between the United States and Japan when the evidence indicated that he had carried on local trade. On appeal from the hearing officer's ruling, the Board of Appeals decided the case on an entirely different ground, namely, that the alien had not applied for the status of visitor, which was also required by the law, to prevent him from being deported. This Court held that this was a denial of due process because the alien had no notice or opportunity to meet this new issue at the hearing.

In *Pan American Airways v. Civil Aeronautics Board,* 171 F. 2d 139 (D. C. Cir., 1948), the Court held that there was a denial of due process where no notice

was given that the rate of return on the airline's investment would be in issue.

In *Gonzales v. United States,* 348 U. S. 407, 99 L. Ed. 467 (1955), the Court, in reliance upon the *Morgan* case, *supra,* held that the defendant who had been convicted of failure to report for induction into the armed forces had been denied due process because he had not been furnished with a copy of the recommendation made by the Department of Justice to the Appeal Board and therefore was not afforded the opportunity of knowing the basis for the recommendations and mustering his facts and argument to meet its contentions.

To the same effect are *Arndt v. United States,* 222 F. 2d 484 (5 Cir., 1955), and *Dobrenen v. United States,* 235 F. 2d 273 (9 Cir., 1956).

These authorities are directly in point in the instant case and can lead to no other conclusion but that respondents were denied a fair hearing because they were not informed that there was any issue before the Court of alleged misrepresentation and concealment, they were not afforded an opportunity of presenting evidence thereon, and were not afforded the right to be heard by counsel on the facts and the law. Under such circumstances they were denied due process of law.

In the instant case more is involved than the matter of fees. The professional standing and reputation of appellants at the Bar is of far greater importance to them than the fees involved. The widely publicized opinion of the District Court holding that they were guilty of misrepresentation and concealment of facts reflects upon their professional reputation. This opinion

has all the aspects of disciplinary action by the Court against appellants. Such action was taken without any notice to appellants that they were charged with any misconduct and without affording them an opportunity to meet such charges. Under these circumstances the decisions of this Court in two disciplinary cases involving attorneys are analogous.

In *United States v. Hicks,* 37 F. 2d 289 (9 Cir., 1930), a somewhat analogous situation existed resulting in the holding by this Court that an attorney was denied due process of law. In that case Raine Ewell, an attorney, appeared in Court and asked leave to file a notice in a criminal case signed by the defendant in that case, advising the Court officers and the attorney of record for the defendant that the defendant had discharged his attorney and appointed Mr Ewell as his attorney. The discharged attorney was in Court and objected to the filing of the notice upon the grounds that it unjustly reflected upon his honor and integrity. The Court continued the matter and at the subsequent hearing made an order disbarring Mr. Ewell. Mr. Ewell contended "that up to a time shortly before the hearing closed, he assumed that the only matter involved was the question" of the other attorney's discharge. This Court said, at page 290:

> "It is not pretended that any charge, formal or informal, was ever filed against appellant or that he was ever advised in terms or clearly that the purpose or one of the purposes of the hearing set for June 1 was to determine whether he should be disbarred. . . . He may well have understood, and we are inclined to think, he did proceed upon the assumption that the only purpose of the hear-

ing was to determine whether his client was entitled to the relief sought, to procure all of which relief he would have to substantiate the grounds stated in the notice."

And, again, at page 291:

"In short, the first intimation in the minutes that appellant's disbarment was involved is to be found in the court's announcement of his final decision. . . . There had been no suggestion of dishonesty on his part."

In the course of these proceedings the Court stated to Mr. Ewell, "Now, you understand that you are on trial here, do you not?", to which Mr. Ewell replied that he did not, and the Court stated that "You had better wake up and take notice." This Court pointed out that even at that juncture of the proceedings appellant was not advised upon what complaint or charge or for what purpose he was on trial. This Court held:

"it is clearly recognized as indispensable that the subject of such a proceeding be advised of the proposed action and of the basis therefor, and that he have his 'day in court.' In other words, he must in advance be informed of the purpose of the proceeding and of the grounds therefor, and be afforded a fair opportunity to interrogate the witnesses testifying against him and to produce evidence in refutation or rebuttal. These are indispensable requirements; if they are substantially met, the form or procedure by which they are complied with is of little importance. See also Ex parte Bradley, 74 U.S. (7 Wall.) 364, 19 L. Ed. 214; Bradley v. Fisher, 80 U.S. (13 Wall.) 335, 354, 20 L. Ed. 646; Ex parte Robinson, 86 U.S. (19 Wall.) 505, 512, 22 L. Ed. 205."

In the case of *In re Los Angeles County Pioneer Society,* 217 F. 2d 190 (9 Cir., 1954), Judge Mathes acting there, as here, "sua sponte" in a bankruptcy proceeding, made an order, without notice to attorney Morris Lavine, that he had committed a fraud upon Judge Harrison by procuring a restraining order, and he thereupon filed an order disbarring Mr. Lavine from practice before the Court. On appeal, this Court held that the District Court's order was wholly void for lack of jurisdiction in the District Court because of lack of due process of law. There, as here, Judge Mathes based his ruling upon the ground that another judicial officer had been defrauded by Mr. Lavine, and he made the order "without opportunity to offer any reasonable defenses or extenuating circumstances." This Court, in reliance upon numerous Supreme Court decisions, and the case of *United States v. Hicks, supra,* quoted from *Ex parte Robinson,* 19 Wall. 505, 22 L. Ed. 205, 208 (1873), as follows:

> "Before a judgment disbarring an attorney is rendered, *he should have notice of the grounds of complaint against him and ample opportunity of explanation and defense. This is a rule of natural justice and should be equally followed when proceedings are taken to deprive him of his right to practice his profession, as when they are taken to reach his real or personal property.* * * * The principle that there must be citation before hearing, and hearing or opportunity of being heard before judgment, is essential to the security of all private rights. Without its observance no one would be safe from oppression wherever power may be lodged." (Emphasis added.)

In his concurring opinion in the *Los Angeles County Pioneer Society* case, Mr. Justice Chambers said at page 195:

> "But here it is charged, I assume, that not even yesterday, but last week, Mr. Lavine did not make a fair disclosure to Judge Harrison, the district judge who signed the orders which were vacated by Judge Mathes. In such a case, *a sense of fair play, which ordinarily is due process, requires notice of the charges, a chance to prepare for defense and, if found guilty, an opportunity to make representations in mitigation.*" (Emphasis added.)

To the same effect see *Ohio Bell Telephone Co. v. Public Utilities Commission,* 301 U. S. 292, 81 L. Ed. 1093 (1936).

In *Goodman v. Street,* 65 F. 2d 686 (9 Cir., 1933), the attorneys for the trustee and receiver filed separate petitions for fees, both of which were allowed by the referee. The attorney for the trustee petitioned for a review, claiming that the amount allowed to him was inadequate. In this respect the case is similar to the instant case where Mr. Harris petitioned for review upon the ground that the amount allowed to him was inadequate. On review the District Court affirmed the Referee's order as to the trustee's attorney but disallowed all fees to the receiver's attorney, just as the District Judge did in the instant case. Thereupon, the receiver's attorney appealed and this Court reversed on the ground that *"The action of the court in this case was without notice or opportunity to appellant to be heard."* The opinion in that case does not disclose whether the

Petition for Review filed by the trustee's attorney asserted that it was error to allow fees to the receiver's attorney. If such was the case, it is analogous to the instant case. While in the instant case appellants did have notice that Mr. Harris was questioning the allowance of fees to them upon the ground that they represented adverse interests, appellants did not at any time have any notice from either Mr. Harris or the Court that it was being asserted that the Referee was in error in allowing them any fees whatsoever upon the grounds that they had misrepresented or concealed facts.

Elementary fairness requires that they have such notice and an opportunity to be heard.

We therefore respectfully contend that the orders appealed from be reversed by reason of the fact that appellants were not given due notice or an opportunity to be heard upon the issue upon which the case was decided by the trial judge, which issue was not raised in the petition for review. The proper procedure in such a case would be for the Court to remand the case to the referee and to permit an aggrieved party, if so advised, to file objections before the referee to the fee petition, for evidence to be taken thereon, and a ruling made by the referee.

2. **The Court Erred in Denying the Motion for Rehearing and Reconsideration of the Order Disallowing Fees.**

The first knowledge or notice that appellants had that the court was of the view that they should be denied any fees whatsoever on the ground of misrepresentation and concealment was about April 7, 1959, following the publication of a portion of the court's Opinion in a Los Angeles legal newspaper [R. 106]. They were indeed shocked at the contents of the Opinion for they had no notice that there was any such issue involved in the case.

They immediately prepared and filed a Motion for Rehearing and Reconsideration, the grounds of which are set forth in the record [R. 104-105] herein and *supra,* pp. 9-10. This Motion was supported by the following uncontroverted affidavits, summarized *supra,* pp. 21 to 26: (1) of Francis F. Quittner dated April 10, 1955 [R. 106-117]; supplemental and second supplemental affidavits of Mr. Quittner dated May 6, 1959 [R. 131-136]; and June 17, 1959 [R. 144-152], filed at the suggestion of the court; (2) original and supplemental affidavits of Milford S. Zimmerman dated April 10, 1959, and June 17, 1959 [R. 137-144]; (3) affidavit of Norman Scheinman, attorney for the special administrator, dated May 1, 1959 [R. 127-130].

These affidavits disclose without contradiction: that neither appellant concealed from or misrepresented facts to the Referee as to the nature, extent or value of the services rendered by them or as to when such

services were rendered; that full and complete information was at all times given to the Referee and that he was not deceived or misled in any respect whatsoever; that Mr. Zimmerman's testimony at the Hearing on Review that there was a tentative agreement of the settlement in May, 1955, was erroneous; that his proposal was rejected by Messrs. Scheinman and Katz, the attorneys for the bank and the principal beneficiaries; that following the appointment of special counsel many negotiation conferences were held between counsel for all of the interested parties, including a representative of Mr. Harris; and that "no agreement was reached" until about December, 1955, when Mr. Quittner suggested to opposing counsel that an increase in that amount might bring about an agreement by Mr. Harris to a settlement. As a result of this suggestion, the amount was increased to $15,000.00 and a settlement agreement reached [R. 129-130; R. 65-66].

Despite this uncontradicted evidence, the court denied a rehearing. This but served to compound the original error of the court in denying appellants due process of law by failing to give notice to them that there was any issue involved of alleged misrepresentation or concealment.

In denying the rehearing [R. 152-161] the court assumed "arguendo" that the facts disclosed by these affidavits were true.

This left only the fee petition and the record certified to the court. The briefs filed on the Motion for Rehearing clearly showed that the court had mis-

construed the fee petition as stating that substantially all of the services referred to by the court in its original opinion were performed after and not before appellants' appointment as special counsel. The opinion denying rehearing made no further reference to this point [R. 152-161]. We therefore assume that the court agreed with appellants' interpretation thereof. In any event, this court is not bound by the District Court's original interpretation thereof and may place its own interpretation thereon. The fee petition is analyzed *infra*. That analysis clearly shows that the court was in error in construing it as stating that substantially all of the services described were performed "following" and not before appellants' appointment.

The petition did not, of course, set forth all of the alleged services in detail for the obvious reason that it was clearly understood at the time of appellants' appointment that they would be paid solely on a contingent basis. We contend that not only was the Referee at liberty to use his own knowledge of the services performed but that, if the petition was not sufficiently detailed or specific, the court should have permitted it to be amended and supplemented to supply additional details and should not have denied all fees upon the ground that all of the services performed were not fully and completely disclosed in the petition.

The court seemed to think, however, that it was necessary to disclose in the Fee Petition each and every detail of service performed by either or both of the appellants [R. 156]. Such detail is not and never has been generally thought necessary, especially in a

case where the Referee is familiar with the services rendered and the fee is to be upon a contingent basis. If the allegations of paragraphs V, VII and X of the Fee Petition [R. 57-59] were not considered sufficiently specific in detail, the proper procedure was not to deny any fees whatsoever but to permit an amended petition to be filed giving greater detail and to conduct a hearing thereon.

That a referee, in fixing fees, is permitted to consider matters which he knows of his own knowledge, is held in the case of *In re Cook's Motors,* 52 Fed. Supp. 1007, 1008 (D. C. Mass., 1943), where the court said:

> *"The first important question is what evidence the referee has a right to consider in forming his judgment as to whether services were rendered by Gar Wood and what their value was.* The referee can plainly take into account the sworn proof of claim. 'A sworn proof of claim is some evidence, even when it is denied.' Whitney v. Dresser, 200 U. S. 532, 536, 26 S. Ct. 316, 317, 50 L. Ed. 584. *He may also take into account any services, such as oral or written arguments, which he personally observed* the creditor perform during hearings in connection with or proceedings for the administration of the bankrupt's estate. Tracy v. Spitzer-Rorick, Trust & Savings Bank, 8 Cir. 12 F. 2d 755, 756. *The underlying principle is that these services are a form of real evidence or autoptic proference.* Wigmore, Evidence, 3rd Ed. §§ 24, 1169. *And courts commonly take such services into account without requiring supplemental proof through witnesses on the stand.* Cf. Hutchinson v. William C. Barry, Inc., D. C. Mass., 50 Fed.

> Supp. 292, 296. However, it is clearly desirable for a referee or court which does fix a fee upon facts learned in open court but not appearing on a written record to state those facts expressly. Otherwise the parties and appellate courts cannot know the basis of his action and hence cannot effectively review it." (Emphasis added.)

In *Watkins v. Sedberry,* 261 U. S. 571, 67 L. Ed. 802 (1923), where the referee held that the statement of an attorney's expenses was not properly itemized and allowed a lesser amount but gave the attorney an opportunity to furnish a statement properly setting forth the claim in detail, the Supreme Court did not totally disallow the amount claimed but affirmed the reduced amount allowed by the referee.

The court brushed aside the evidence in the affidavits disclosing that Mr. Quittner made full disclosure to Referee Head of all facts known by him and said that the Referee was not advised of the written offer of settlement of May 11 or the counter offer of May 17 [R. 157]. Since the offer made by Mr. Zimmerman on May 11 was not accepted but was rejected, we have difficulty in understanding how the terms of a rejected offer would be material to the Referee even if Mr. Quittner had known of that offer. A rejected offer or a counter offer cannot be the basis of a contract. The original offer cannot be thereafter accepted by the offeree. Restatement Contracts Secs. 38, 60. *Niles v. Hancock,* 140 Cal. 157 (1903); *King v. Stanley,* 32 Cal. 2d 584, 588 (1948).

In denying rehearing the Court conceded the truthfulness of the facts contained in the supporting affi-

davits but stated that a rehearing would not bring about a different result [R. 155]. It must be manifest to any fair and unbiased person that the true facts as disclosed in the affidavits conclusively show that there was no misrepresentation or concealment and that the Referee, who had full knowledge of all of the facts, was not deceived or misled. It was clearly unnecessary in a fee petition seeking fees solely upon the contingent basis the Referee had stated would be used in allowing fees, that is, a contingent fee based upon a percentage of the recovery, that the appellants should set forth in the petition each and every conference, conversation or telephone call, or the substance of every discussion that was had, or of each minute detail of work performed. These particulars were unnecessary because the fee, according to the Referee's prior statement was going to be and was based upon the results obtained.

Furthermore, since the Court accepted as true all of the facts stated in the affidavits, it necessarily followed that the Court rejected Mr. Zimmerman's erroneous statements relative to the offer of settlement being tentatively accepted in May, 1955. Since the Court's original opinion was primarily predicated upon that erroneous testimony, when it is eliminated from the case the only thing before the Court was the fee petition itself. Based upon that petition alone the Court at the outset of the review proceeding stated that it was "satisfied with the Referee's findings" "as to what services were performed and the reasonable value of them". That statement was equally

applicable on the motion for rehearing. There is no sound reason why the rehearing should not have been granted and the matter referred back to the Referee, who was allegedly deceived, to permit the fee petition to be amended and further proceedings to be taken on the value and extent of the services rendered by appellants, and the issue, if any, of misrepresentation or concealment.

The denial of appellants' Motion for Rehearing but served to compound the original error in denying them due process of law. Since they had no notice of the issue decided by the court *sua sponte* and no opportunity to present evidence thereon, their sole recourse was to move for a rehearing and insist upon their right to be accorded due process of law. The issue decided by the court *sua sponte* was not presented to the Referee and was not specified as a ground of error in the Petition for Review. In raising and deciding this issue *sua sponte,* the court violated the well-established rule that a reviewing court will not consider or pass upon questions which were neither pressed nor passed upon by the court from which the review was taken. The reason for this rule is that orderly procedure and elementary justice require that all questions upon which appellate reliance is placed for reversal, must have been appropriately brought into the record at the right juncture and the hearing tribunal afforded an opportunity of ruling thereon. *United States v. Atkinson,* 297 U. S. 157, 80 L. Ed. 555 (1936); *Helvering v. Cement Investors, Inc.,* 316 U. S. 527, 86 L. Ed. 1649 (1942); *Delgadillo v.*

Carmichael, 332 U. S. 338, 92 L. Ed. 17 (1947); *McCullough v. Kammerer Corp.,* 323 U. S. 327, 89 L. Ed. 273 (1945); *McComb v. Goldblatt Bros.,* 166 F. 2d 387 (7 Cir., 1948); *Maloney v. Brandt,* 123 F. 2d 779 (7 Cir. 1941).

The language in *Maloney v. Brandt, supra,* at page 782, is pertinent:

> "It has long been a rule of practice that a reviewing Court will not consider assignments of error not called to the attention of the trial court where such matters do not concern the jurisdiction of the court. *It would manifestly be unfair to hold that the trial court had erred in a matter it had not considered. Litigants are not entitled to hide a point in an obscure pleading and present it for the first time on review, but should fully and fairly acquaint the trial court with all matters relied upon."* (Emphasis added.)

In *Ramming Real Estate Co. v. United States,* 122 F. 2d 892, 893-894 (8 Cir., 1941), the court said:

> "The general rule, subject to certain exceptions not here material, is that the appellate court will consider only such questions as were raised and preserved in the lower court. This rule is one of necessity in the orderly administration of law and in fairness to the court and the opposite party. . . . *It is well settled that the theory upon which the case was tried in the court below must be adhered to on appeal."* (Emphasis added.)

This rule is applicable to reviews of orders of referees in bankruptcy. Fairness and elementary justice demand that the referee be not found guilty of

error in a ruling he has never made upon an issue to which his attention has never been called. The obvious purpose of Section 39(c) of the Bankruptcy Act in requiring that a petition for review shall set forth the alleged errors complained of is to limit the review to those matters which were passed upon by the referee. (*In re McCann Bros. Ice Co.,* 171 Fed. 265 (D. C. E. D. Pa., 1909); *In re Cohn,* 171 Fed. 568 (D. C. N. Dak., 1909); *In re Rome,* 162 Fed. 971 (D. C. N. J., 1908).)

Every person is entitled to fair notice of the issues raised and to be afforded an opportunity to meet them. Every referee and judge is entitled to be advised of the issues presented and afforded an opportunity to rule thereon after full hearing. An issue not raised before the trier of fact cannot generally be raised on review.

3. The Order of the Referee Allowing Fees to Appellants Was Not Clearly Erroneous.

The order of the Referee allowing attorneys' fees to appellants was binding upon the District Court and is binding upon this Court unless that order was "clearly erroneous" (General Order 47, 11 U. S. C. A. following Sec. 53).

While the second sentence of General Order 47 provides that the reviewing judge, after hearing, may adopt, modify or reject the report of the Referee, or may receive further evidence, or re-commit it with instructions, nevertheless this may be done only if the Referee's determination is clearly erroneous and a

gross miscarriage of justice would otherwise result. (*Rosehedge Corporation v. Sterett,* 274 F. 2d 786, 790 (9 Cir., 1960); *Powell v. Wumkes,* 142 F. 2d 4 (9 Cir., 1944); *Hoppe v. Rittenhouse,* ..... F. 2d ..... (9 Cir., May 16, 1960).)

The power conferred by the second sentence of this order is limited by the language of the first sentence to cases where the finding of the Referee is "clearly erroneous". (*Equitable Life Assurance Society of the United States v. Carmody,* 131 F. 2d 318, at 322 (8 Cir., 1942); *Morris Plan Industrial Bank v. Henderson,* 131 F. 2d 975 (2 Cir., 1942); *In re Lurie Bros. Inc.,* 267 F. 2d 33, at 35 (7 Cir., 1959).)

The order of the Referee allowing fees to appellants for their services was a finding of fact that they had performed services and that the amount allowed was reasonable compensation for the services performed by them. (*Klein v. Rancho Montana De Oro, Inc.,* 263 F. 2d 764 (9 Cir., 1959).)

In the present case, the court, in affirming the Referee's order denying Mr. Harris additional fees, said [R. 102]:

> "Clearly then, *the Referee's determinations here were largely factual in nature* (citations), and so are not to be upset unless found to be 'clearly erroneous' (citations); as *it is the Referee, charged with responsibility of supervising day to day administration of the bankrupt estate, who is most familiar with and hence best able to appraise 'the value and extent of the services rendered'.*" (Emphasis added.)

Assuming, *arguendo,* that the question of whether appellants should be denied fees was properly before the District Court, the determination made by the Referee that they were entitled to fees was not clearly erroneous.

The complete record of the proceedings before the Referee on the fee petition were not before the court upon the review. The testimony or statements made by the respective petitioners, if any, and the statements and comments of the Referee are not in the record. The Referee's version of the matters and facts considered by him in making the fee allowances and his version of whether he was misled or deceived by the fee petition were not part of the record on review. The court denied appellants' motion to request the Referee to certify these facts with respect to the issue raised and decided by the court *sua sponte.*

In the absence of the complete record of the proceedings before the Referee, it is presumed that the Referee's findings were correct and supported by the evidence. (*Griffiths Dairy v. Squire,* 138 F. 2d 758 (9 Cir., 1943); *Hudson v. Wylie,* 242 F. 2d 435 (9 Cir., 1957); *In re Duffin,* 141 Fed. Supp. 869 (D. C. S. D. Cal. 1956).)

The Referee was entitled to take into account not only the verified fee but his personal knowledge of the services performed by appellants in the administration of the estate with respect to the will contest. The nature of those services is best known to the Referee, and his evaluation thereof is a matter of judgment rather than knowledge. (*In re Cooks Motors, Inc.,*

52 Fed. Supp. 1007 (D. C. Mass., 1943); 3 Collier on Bankruptcy, p. 1617; *In re Folker,* 47 Fed. Supp. 522; (D. C. E. D., Mich. 1942); *In re Melhado,* 1 Fed. Supp. 591 (D. C. W. D. Pa., 1932); *In re American Range and Foundry Co.,* 41 F. 2d 845 (D. C. Minn., 1926).)

In his original opinion Judge Mathes misconstrued the fee petition as stating that "following" their appointment as special counsel appellants performed certain services, such as investigating potential witnesses, that they determined that successful prosecution of the will contest was improbable, and then proceeded to negotiate to settle the matter, and expended approximately 160 hours performing those services which resulted in recovering $15,000.00, an increase of more than 100% over the original nuisance offer, that services were rendered on a contingency basis and that appellants failed to state in the fee petition that a substantial part of these hours had been spent and a large part of the services rendered before appellants were employed and not afterwards, whereas, substantially all of the negotiations and services referred to had taken place prior to the appointment of appellants [172 Fed. Supp. 374, 379; R. 89]. An analysis of the fee petition discloses that the court misconstrued its language and intent. The Referee did not so construe the fee petition, and this court is not bound by the District Court's construction thereof, for this court is in as good a position as the District Judge to construe the petition. (*Republic Pictures Corp. v. Rogers,* 213 F. 2d 662 (9 Cir., 1954); *Stevenot v. Norberg,* 210 F. 2d 615 (9 Cir., 1954);

Kwikset Locks, Inc. v. Hillgren, 210 F. 2d 483 (9 Cir., 1954); *United States v. McShain, Inc.,* 258 F. 2d 422 (D. C. Cir., 1958); *Weible v. United States,* 244 F. 2d 158 (9 Cir., 1957).)

All services performed in the will contest prior to appellants' appointment were performed by Mr. Zimmerman and his firm. He consulted Mr. Quittner concerning the bankruptcy aspects of the matter and requested Mr. Quittner to associate with him in the will contest, principally to advise him with respect to the applicable bankruptcy law.

As shown in the Statement of the Case and Statement of Undisputed Facts, *supra,* and by the uncontradicted affidavits filed in support of the Motion for Rehearing, the allegations of which must be accepted as true, Mr. Quittner made full and complete disclosure to the Referee of all facts known to him concerning the then status of the will contest, the negotiations to settle the same, and the extensive and substantial services theretofore rendered by Mr. Zimmerman which included the filing of the will contest, the taking of depositions, the making of investigations and the conduct of settlement negotiations by which Mr. Zimmerman hoped to effect some recovery for Mr. Barry personally. Mr. Quittner did not advise Referee Head of the May 11 proposal made by Mr. Zimmerman because Mr. Quittner had no knowledge of it. *Referee Head,* although expressing doubts as to the successful outcome of the will contest, *stated that it would be beneficial to the bankrupt estate to appoint Mr. Zimmerman as special counsel because of*

his familiarity with the will contest and the problems involved therein and that the bankrupt estate would thereby obtain the benefit and advantage of the substantial services he had already performed. But the Referee was emphatic in stating that any compensation of special counsel would be solely on a contingent fee basis of a percentage of the recovery [R. 145-149]. This fact was clearly disclosed in both the Petition to Employ Special Counsel [R. 14] and the Fee Petition [R. 59, par. X]. The Petition to Employ Special Counsel was supported by the affidavits required by General Order 44. Referee Head was kept informed by Mr. Quittner of the progress of the settlement negotiations, and he had personal knowledge thereof, as disclosed at the hearing on the petition filed by appellee to remove appellants as special counsel [R. 19-21].

An analysis of the Fee Petition discloses that the District Court's construction thereof is erroneous. That petition does not allege that substantially all of the services therein described were performed "following" and not before appellants' appointment as special counsel.

Paragraphs I and II of the Petition [R. 53-54] state that appellants were appointed as special counsel and narrate background information concerning the filing of the petition to probate Mrs. Barry's will, the filing of a contest before probate and the grounds thereof, and the fact that the court authorized the Receiver to employ appellants as special counsel.

Paragraph III states, in part, that "*Following* the issuance of the above order of this court, *numerous*

and complicated questions faced your petitioners in their efforts to recover for the bankrupt estate any amount from the probate estate of Charlotte Barry." The allegations of the answer to the will contest disclosing the issues joined and the defenses pleaded are then summarized. These disclose the principal beneficiaries' contentions as to why Mr. Barry was disinherited in his wife's will. This paragraph does not state or purport to state that the matters there set forth constituted services rendered by either appellant "following" their appointment. It merely sets forth some of the numerous and complicated questions and problems facing appellants in their efforts to settle the will contest.

Paragraph IV of the Petition [R. 56-57], referred to by the court in its opinion as a representation by appellants that the matters there referred to were performed after rather than before their appointment as special counsel, is not subject to the interpretation placed thereon by the court. Paragraph IV, without reference to any time whatsoever, states that the petitioners made a thorough investigation of potential witnesses and record facts in the hope of securing evidence to support the grounds of the will contest. The Referee had been already informed of the fact that Mr. Zimmerman had performed extensive services in the will contest, had participated in the taking of depositions, and had carried on negotiations with the attorney for the executor looking towards a settlement [R. 145-148]. There can be no doubt of the fact that prior to the date of appointment of special counsel, Mr. Zimmerman had made investigations of po-

tential witnesses and facts inasmuch as he had filed the will contest, and had participated in the taking of depositions and other court proceedings. Since Mr. Quittner had not participated in those proceedings, it was obviously necessary for Mr. Zimmerman to fully inform Mr. Quittner of all of the facts and potential witnesses that he had uncovered as a result of his activities, and for Mr. Quittner to appraise the facts and evidence. It was essential that both counsel determine whether they should proceed with settlement negotiations or to trial. In fact it was beneficial to the bankrupt estate to continue the employment of Mr. Zimmerman because of his intimate knowledge of the facts, witnesses, and possibilities of settlement. If a total stranger to the will contest had been employed by the Receiver, it would have been necessary for him to investigate facts and witnesses, read depositions, and commence negotiations anew. Since Mr. Quittner was a stranger to the will contest, it was necessary for him to rely upon what Zimmerman had previously done. The intent and purpose of Paragraph IV of this Fee Petition is explained by Mr. Quittner in an affidavit filed in support of the Motion for Rehearing and Reconsideration [R. 108-109, par. 4; R. 113, par. 13]. Paragraph IV also states that in view of the fact that no moneys were available for further investigation appellants concluded to proceed with negotiations with the executor for the purpose of securing the payment to the bankrupt estate of the largest sum available in compromise of the will contest [R. 56-57]. Referee Head was kept informed

by Mr. Quittner of the progress and problems involved in the settlement [R. 111].

Paragraph V of the Fee Petition [R. 57] states that *in attempting to reach a settlement* for the purpose of securing assets for the bankrupt estate *there were new and additional problems presented,* some of which are set forth: Appellants learned for the first time that an action had been filed by appellee against the special administrator based on rejected creditors' claims filed in the probate estate, and that the executor and principal beneficiaries insisted, as a condition of settlement, that these claims be withdrawn and the action thereon dismissed. Appellants first learned of these claims by the letter of Mr. Scheinman dated July 14, 1955 [R. 143; R. 114-117]. The imposition of the dismissal of this action as a condition to the settlement of the will contest was new. Appellants had no control over the action on the rejected creditor's claims. The imposition of this condition placed appellee and his clients in a position where they could hinder or prevent settlement of the will contest by refusing to dismiss the action on the rejected creditor's claims. That is exactly what appellee Harris did by notifying all interested parties on July 22, 1955, that his clients would not approve the settlement proposal made by Mr. Scheinman in his letter of July 14 [R. 110]. This stalemate resulted in numerous conferences attended by the interested parties without affecting a settlement [R. 120, 129, 150]. In addition, Mr. Harris filed a petition to remove appellants as special counsel and that they be denied all fees for

services theretofore performed upon the grounds that they represented adverse interests [R. 18-21]. Appellants continued to negotiate with Messrs. Katz and Scheinman [R. 130, 66], but the latter were adamant in insisting that the entire controversy, including the dismissal of the action on the creditor's claims and of the involuntary petition in bankruptcy against Mrs. Barry's estate, be part of the settlement. Mr. Quittner suggested that the amount of the offered settlement be increased to satisfy Mr. Harris and his clients. This was done and the settlement then agreed upon. Since appellants had no knowledge of the action on the rejected creditor's claims until the middle of July, 1955, it is obvious that all services performed by them with respect thereto were performed after and not before their appointment.

Another new problem was that after appointment of special counsel, and on July 22 and August 17, 1955, Mr. Barry had assigned to one Jack Schwartz all of Barry's interest in the Barry homestead and executed to him an irrevocable power of attorney coupled with an interest. He had entered into contracts with Mr. Schwartz and become further indebted to him. Since the right to $12,500.00 of the probate homestead proceeds was involved in the proposed settlement, these facts required obtaining Mr. Schwartz' consent to any settlement. This required further negotiations with the attorneys for the executor, the petitioning creditors, and Mr. Schwartz. It is obvious that since these transactions all occurred after appointment of appellants, all services performed

by them were performed after and not before their appointment.

Paragraph VI of the Fee Petition does not state when the deposition of Mr. Barry was taken or when the appearances were made in the probate court, but it is clear from the affidavit of Mr. Quittner that he had informed Referee Head of these facts, and that Mr. Zimmerman had performed these services before special counsel were ever appointed [R. 145-149; R. 133-134].

Paragraph VII of the Fee Petition sets forth that the negotiations conducted by appellants were concluded shortly prior to January 12, 1956, resulting in the payment to the Receiver of $15,000.00 in settlement of the will contest, which was more than 100% over the original nuisance offer, that it was the opinion of appellants that this represented the largest sum obtainable through compromise, and that a petition to compromise was filed and approved by the Bankruptcy Court and also by the Probate Court. It is obvious that these matters occurred after and not before appointment of special counsel.

Paragraph VIII states that appellants spent approximately 160 hours in the performance of the special services. This was not intended to refer to services rendered before appointment of special counsel. Since special counsel had been informed by the Referee that they would only be paid on a contingent fee basis dependent upon the amount of the recovery effected, they did not keep any accurate or complete time records of the amount of time that they spent

on the matter. All of the time spent by Mr. Quittner was spent by him after his appointment as special counsel because he had nothing to do with the will contest prior thereto. It is not usual or customary for attorneys who are working on a contingent fee arrangement to keep any record of the time spent by them in the performance of their services.

In the affidavit submitted in support of the Motion for Reconsideration Mr. Zimmerman sets forth the services performed by him before and those performed by him after his appointment as special counsel. His fee arrangement with Mr. Barry was a contingent fee arrangement and hence he maintained no time sheets as part of his office records since the amount of the fee would not be dependent upon the time devoted to the matter. His calendar, however, does disclose court appearances, telephone calls and conferences. They disclose appearances in the Superior Court and before the Referee, the taking of the Barry deposition, and meetings with Mr. Barry and others, with the result that he estimated that he and members of his firm devoted between 400 and 500 hours on the probate matter, of which not less than 150 hours was spent after the appointment of special counsel in connection with the compromise of the will contest and the claim of Mr. Barry to the homestead proceeds, and of that 150 hours a substantial portion was spent with respect to the will contest [R. 140-143]. Mr. Quittner's affidavit [R. 149-151] discloses that it was not his practice to keep time sheets on contingent fee cases, that when the Fee Petition was prepared he and Mr. Zimmerman reviewed the matter, and he informed

Mr. Zimmerman that time was not an element because the matter was handled on a contingent fee basis, and that in an ordinary case from 25% to 33⅓% was customarily allowed, that Mr. Zimmerman related to him the amount of time that he and his firm had devoted to the case, and Mr. Quittner recalled having had at least 12 conferences with the Referee, about 20 other conferences, and at least 40 telephone conferences with the interested parties, had carried on correspondence, participated in the drafting of the final settlement stipulation, had made a minimum of two court appearances, and that between them they agreed that the figure 160 hours was approximately correct and the best estimate that could be made of the time spent after their appointment as special counsel. Since appellants were appointed as special counsel pursuant to a distinct agreement with the Referee that they would be compensated solely on a contingent basis of a percentage of the amount recovered, it would have been a violation of that agreement to seek compensation solely on an hourly basis. The keeping of time records was wholly unnecessary.

Although the Court in its original opinion misconstrued the Fee Petition, the briefs and arguments on the Motion for Rehearing analyzed the Fee Petition in detail and pointed out that the Court was in error in its interpretation thereof. No further reference thereto was made by the Court in its opinion denying rehearing and it may therefore be assumed that the court concluded that it did misconstrue that petition. On the rehearing the court conceded, *arguendo,* that the testimony given by Mr. Zimmerman on the original

hearing was erroneous and that the 160 hours of estimated time was devoted after and not before appellants' appointment, and that there was no settlement agreement, tentative or otherwise, on the date of appellants' appointment. Assuming, as we must, the truthfulness of the facts contained in the supporting affidavits, it is manifest that unless the Fee Petition itself contains misrepresentations of fact or omits material facts, that there is no basis for the court's ruling. The above analysis of the Fee Petition discloses that there was no misrepresentation and that it was superfluous to set forth in a contingent fee case the details of each and every conference, telephone call, and other transaction that was had. The court was in error in stating otherwise [R. 156-157]. There is no good reason why the affidavits should not be considered as part of the Fee Petition as supplying detailed information which the court, rather than the Referee, apparently believed was required.

In any event, we respectfully contend that the trial court should have notified appellants that there was an issue in the case involving misrepresentation and concealment, permitted the filing of objections to the fees upon that ground, and set the matter down for hearing so that they would have fair notice of the charges and afforded an opportunity of meeting them. If the Fee Petition was insufficient in detail, appellants should have been afforded an opportunity of supplementing and amending the same instead of being disallowed all fees whatsoever. In *In re Smith,* 203 Fed. 369 (6 Cir., 1913), where the objection was made on appeal that the claim was not itemized in detail, the

court said "The objection of lack of detail in the claim was largely addressed to the discretion of the court." In *In re Realty Foundation, Inc.*, 75 F. 2d 286, 288 (2 Cir., 1935), the District Court had taken jurisdiction of a petition for review and had reversed the referee's order. The Court of Appeals, in reversing the District Court's order, held that the District Court had no power to review the decision of the referee upon a petition taken by a person having no legal interest in the premises.

4. The Court Erred in Denying All Fees to Appellants.

It being clear from the record that appellants, as special counsel, did render services to the bankrupt estate and on a contingent fee basis and that the Referee, who was far more familiar with the facts concerning the extent and value of the services rendered than was the Reviewing Judge, believed that such services which effected a recovery of $15,000.00 were worth 25% of that amount, the Reviewing Judge, if he believed that the amount so allowed was excessive, should have reduced that amount rather than deny appellants all fees for services admittedly rendered by them.

Judge Mathes was apparently of the view that it was mandatory, under General Order 44, to deny counsel any and all fees for services rendered by them prior to their appointment as special counsel. The basis of his first opinion was that substantially all services were rendered before appellants' appointment and that they were not entitled to fees for such services even though such services might be of great benefit to the

bankrupt estate. If, as a matter of law, attorneys are entitled to be compensated for such services, the court's ruling was in error.

As previously stated, all services rendered before June 27, 1955, were rendered by Mr. Zimmerman and his firm as attorneys for Mr. Barry in connection with the probate estate of Mrs. Barry.

The Opinion [R. 92] cites several cases for the proposition that attorneys for a receiver or trustee are not entitled to any compensation for services, however beneficial to the bankrupt estate, if rendered prior to their appointment by the Referee and not in compliance with General Order 44. It may be conceded that the cited cases do so hold. However, an analysis of General Order 44 and of the cases themselves discloses that that Order does not by its terms provide that an attorney for a receiver is not entitled to compensation for services rendered prior to his appointment. It only states that if services are performed when a petitioner fails to disclose that he represents an adverse interest that the court *may deny* him fees.

In the instant case, General Order 44 was complied with, and the required affidavits were presented to the Referee.

The case of *Beecher v. Leavenworth State Bank,* 184 F. 2d 498 (9 Cir., 1950), held that an attorney who rendered *ordinary services* to a trustee without having been appointed as his counsel was not entitled to compensation. The services involved were the ordinary services of operating the bankrupt's property.

The other cited cases all are of the same kind, that is, involving the performance of *ordinary services* and not the recovery of assets for the bankrupt estate.

It is well established that in courts of equity a trust fund which has been recovered may be charged with costs and expenses, including reasonable attorney's fees incurred in such recovery. (*United States v. Equitable Trust Company,* 283 U. S. 738 75 L. Ed. 1379 (1931); *Sprague v. Ticonic National Bank,* 307 U. S. 161 83 L. Ed. 1184 (1939); *Arenas v. Preston,* 181 F. 2d 62, 64 (9 Cir., 1950); *United States v. Anglin & Stevenson,* 145 F. 2d 622 (10 Cir., 1944); *In re Chicago, Milwaukee, St. Paul Railroad Co.,* 138 F. 2d 433, 436 (3 Cir., 1943).)

It is also settled that the bankruptcy court operates as a court of equity and that this equitable fund doctrine is applicable in bankruptcy proceedings. *In re Chicago, Minneapolis & St. Paul Railroad Co.,* 121 F. 2d 371 (7 Cir., 1941); 138 F. 2d 433, 436 (7 Cir., 1943).

In *In re Brigantine Beach Hotel Corp.,* 197 F. 2d 296, 299 (3 Cir., 1952), an attorney, before the institution of proceedings under Chapter XI, had filed a suit for the purpose of setting aside a conveyance of the debtor's hotel property. As a result of this action, the debtor received a reconveyance of this property which was its principal asset. The Court of Appeals in affirming an allowance to him for these services rendered by him *before any appointment of counsel was made,* applied the equitable fund doctrine and said: "After careful study of the attorney's work the trial court felt that '. . . for the benefit derived by the

estate of the debtor and the creditors herein . . . a fair allowance to Mr. Blum would be the sum of seven hundred dollars ($700.00.) . . .' There is a denial of the facts on which the application is founded but this is not seriously pressed. . . . Under all of the circumstances we think the allowance of a fee to the attorney was within the discretion of the district judge and, further, that the amount allowed was a rightful exercise of that same discretion."

In *Watters v. Hamilton Gas Co.,* 29 Fed. Supp. 436 (D. C. S. D. W. Va., 1939), it is stated that *"Services rendered prior* to the institution of the corporate reorganization proceedings in this case, the receivership and foreclosure suits in equity, may be compensated as part of the costs of reorganization, if of value in the formation and adoption of the reorganization plan." See also: *In re Buildings Development Co.,* 98 F. 2d 844 (7 Cir., 1938); *Silver v. Scullin Steel Co.,* 98 F. 2d 503 (8 Cir., 1938).)

These cases applying the equitable fund doctrine are applicable to the present situation. Here it was Mr. Zimmerman who promptly filed the contest before probate. If this had not been done the will would have been admitted to probate and the right to contest the same would have been barred by limitations within six months after November 29, 1954. (California Probate Code Sec. 380.) As of the date of the appointment of special counsel for the Receiver it would have been too late for the Receiver to have filed a will contest. It was only as the result of the filing of this contest and the services thereafter performed by Mr.

Zimmerman that the will contest was kept alive. As a result of the services performed by him before appointment as special counsel and those performed by both appellants after their appointment that the estate recovered $15,000.00, thereby increasing its value by more than 100%. They were specifically informed by the Referee that they would be paid solely on a contingent basis of a percentage of the amount of recovery. This is what they asked for and this is what the Referee allowed.

Under these circumstances we respectfully contend that this is a case for the application of the equitable fund doctrine and that they are entitled to be compensated for the services rendered by them. They should not be denied all fees because of an erroneous statement made by Mr. Zimmerman during one of the hearings.

Since no services were performed by Mr. Quittner before his appointment as special counsel and since he had no knowledge whatsoever of the proposal made by Mr. Zimmerman to Mr. Scheinman in the May 11 letter, it is wholly unfair to find him guilty of misrepresenting to or concealing from the Referee facts concerning which he had no knowledge whatsoever. Since he admittedly rendered valuable services to the estate, he should not be denied compensation for those services on some theory of vicarious liability. An attorney is not liable to discipline for acts of an associate, or even a partner, of which he had no knowledge and in which he did not participate. *In re Luce,* 83 Cal. 303, 305 (1890); *Yale v. State Bar,* 16 Cal. 2d 175 (1940).

Since it is clear and uncontradicted that Mr. Quittner (1) made full disclosure to the Referee of all facts known to him, (2) performed valuable services that he was employed to perform after and not before he was appointed to do so, (3) that those services, in part, resulted in the recovery of $15,000.00 for the bankrupt estate, (4) performed other compensable services, and (5) did not misrepresent or conceal facts, he certainly should not be denied compensation for his services. To permit this ruling to stand in the face of the record before this Court is unfair and unjust to Mr. Quittner, a reputable member of the bar of this Court.

Mr. Zimmerman had filed the will contest for Barry, had made the necessary investigations, attended court hearings and depositions. All of this work was essential in order to secure Barry's right of contest. Without this work by Zimmerman there would have been no recovery for the trustee in bankruptcy. At the time the petition for the appointment of Zimmerman and Quittner as attorneys for the Receiver was filed, the statute of limitations had long since run on the right of any one to contest the will. These are facts which presumably the Referee, Quittner, and everyone else knew. But Mr. Zimmerman had no experience in bankruptcy matters. He had to rely on the experience and advice of Quittner in this field. He did not consult with the Referee. He advised Quittner of what had been done, and Quittner advised the Referee. But now Zimmerman, a reputable member of the Bar, is branded by the District Judge as a fraud

and a cheat upon no evidence whatsoever. Zimmerman, made no misrepresentations of fact to the Referee. The petition for fees correctly describes his work, both before and after the petition for appointment of counsel was filed with the Referee. But the District Judge quarrels with the petition because it did not affirmatively state that Zimmerman had performed these services before he was appointed. This is absurd. Zimmerman is being penalized for failing to state something that was obvious. The Referee was told of Zimmerman's efforts to preserve the rights of Barry to contest before the petition was ever filed. The petition itself cites that the contest was pending. Anyone with an elementary knowledge of probate procedure would know that legal services had been performed prior to June, 1955, which were essentially prior to presenting the rights of the bankrupt or the bankrupt estate to contest the will.

The decisions of the District Judge are essentially unfair to an honest lawyer who should in all justice get paid for a job well done. The decisions broadcast to the entire profession an assertion that Zimmerman and Quittner are dishonest. This conclusion has no support in any fact. The decisions must be set aside, not only because Quittner and Zimmerman were not permitted to defend themselves, but also because they are based upon no evidence, and the decisions must be set aside as a repudiation of the conclusion that Zimmerman and Quittner are other than honest men.

5. Appellee Was Not a Party Aggrieved by the Order Awarding Fees to Appellants.

As shown above, appellants, appellee and others filed separate petitions for fees. The Referee made a single order thereon. Appellee had petitioned for $3,000.00 for services for the petitioning creditors and an additional $5,000.00 for extraordinary services allegedly rendered by him for the benefit of the estate. The Referee allowed $1,250.00 as fees for services of appellee as attorney for the petitioning creditors and denied the balance of the petition upon the grounds that the services rendered by appellee to the Receiver were gratuitous and that the Referee had previously denied two petitions to appoint appellee as attorney for the Receiver because appellee represented adverse interests.

Under Bankruptcy Act Section 39(c) [11 U. S. C. Sec. 67(c)], only a "person aggrieved" by a Referee's order may petition for review of the same. A party is "aggrieved" under this section if his property may be diminished, his burden increased, or his rights detrimentally affected by the order sought to be reviewed. (*Klein v. Rancho Montana De Oro, Inc.* 263 F. 2d 764, 771 (9 Cir., 1959).)

Appellee was a person aggrieved by the Referee's order only to the extent that he was not allowed as much fees as he believed he should receive. But, clearly, he was not a party aggrieved by the order allowing fees to special counsel because that order did not diminish appellee's property, increase his burden, or detrimentally affect any of his rights. While

appellee was asserting that he was in part responsible for the settlement of the will contest, he was not counsel of record therein and had no control whatsoever over that contest. He was not counsel for the Receiver and did not represent him in the will contest. Irrespective of the amount of fees awarded to special counsel for services in the will contest, appellee would not have been entitled to any part thereof.

6. There Was No Issue Before the Court of Alleged Conflict of Interests on the Part of Appellants Because the Referee's Order Determining That Appellants Did Not Represent Conflicting Interests Was Final and Res Judicata.

In his Petition for Review appellee asserted, among other things, and it appears from the record herein [R. 18-21], that appellee on behalf of the Receiver petitioned the Referee to remove appellants as special counsel upon the grounds, among others, that "they represent adverse interests in so acting as special counsel for the Receiver", and that such petition was denied on October 7, 1955 [R. 24-25].

This denial constituted an adjudication that appellants did not represent adverse interests.

Under Bankruptcy Act Section 39(c) (11 U. S. C. A. Sec. 67(c)) this order adjudicating that appellants did not represent adverse interests and that they were entitled to fees for their services became final on October 17, 1955.

Since no review was taken therefrom this constituted a final adjudication that appellants did not rep-

resent adverse interests and that they were entitled to fees for their services as special counsel. (*In re Sterling,* 125 F. 2d 104, 107 (9 Cir., 1942); *Clark v. Milens,* 28 F. 2d 457 (9 Cir., 1928).)

In appellee's Petition for Review he asserted that appellants should be denied any fees because they represented adverse interests and that if any fees should be awarded to appellants $400.00 would be reasonable for the work done by them [R. 77]. This was the only ground asserted as error of the Referee to the award of fees made to appellants. Assuming, *arguendo,* that appellee was a party aggrieved entitled to raise such an issue, that issue was not properly before the court on review because of the final order made by the Referee determining that appellants did not represent adverse interests. The court should therefore have summarily denied the review and affirmed the order allowing fees to appellants upon the principle of *res judicata.* There was certainly nothing of which appellants had notice that would permit the court to deny them any fees or reduce the amount of the fees allowed on the grounds of misrepresentation or concealment. That the issue of adverse interests was the limited and narrow issue which the court believed was properly before it, is manifest from the statement of the court at the outset of the hearing that he felt inquiry should be made into the charge of conflict of interests and that he was satisfied that the Referee's findings as to the services performed by appellants and the reasonable value of them. The court was in error in proceeding with hearing on the issue of adverse in-

terests because of the finality of the order of October 7, 1955.

While it is true that in some cases the District Court, on review of a referee's order, is not limited as is the Court of Appeals, nevertheless a petition to review an order of a referee does not contemplate a general review of the entire proceeding before the referee, but the court is limited to issues presented by the record before it to orders and issues which have not become final. Otherwise there would be no finality to a referee's reviewable orders and the doctrine of *res judicata* would never apply. (See *In re Samuel Wildes Sons,* 144 Fed. 972 (3 Cir., 1906); *In re Elmore Cotton Mills,* 217 Fed. 810 (D. C. S. D. Ala., 1914); *In re Kellar,* 192 Fed. 830 (1 Cir., 1912); *In re T. L. Kelly Co.,* 102 Fed. 747 (D. C. E. D. Wis., 1900); *In re Stokes,* 185 Fed. 994 (D. C. S. D. Ga., 1910).)

We respectfully contend, therefore, that the sole issue which the court advised appellants was to be considered was not in fact an issue properly before the District Court.

It follows that appellee was not a party aggrieved by the order allowing fees to appellants and that there was no issue of adverse interests properly before the court on review which would authorize the court to disallow or reduce the fees allowed.

Conclusion.

For the above reasons, the orders appealed from should be reversed and the cause remanded to the District Court with directions to affirm the Referee's order awarding fees to appellants.

Respectfully submitted,

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J. E. SIMPSON,
Attorney for Appellants Francis F. Quittner, and Quittner & Stutman.

No. 16702

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SUPARIC CHEMICAL COMPANY, a corporation, GERALD L. FARMER, HAZEL I. FARMER, JOHN CARTER BAKER and PATRICIA BARER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of Decisions of the Tax Court of the United States.

BRIEF FOR THE PETITIONERS.

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No. 16702

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SCHALK CHEMICAL COMPANY, a corporation, GERALD I. FARMAN, HAZEL I. FARMAN, JOHN CARVER BAKER and PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of Decisions of the Tax Court of the United States.

BRIEF FOR THE PETITIONERS.

Opinion Below.

The findings of fact and opinion of the Tax Court [R. 39-67] are reported at 32 T. C. 879.

Jurisdiction.

The petition for review [R. 70-76] involves Federal income taxes for the years 1950 and 1951. The notices of deficiency were issued and mailed by the Commissioner of Internal Revenue on May 23, 1956 [R. 6, 14, 22]. Within ninety days thereafter (specifically on August 20, 1956) taxpayers filed petitions with the Tax Court for a redetermination of the deficiencies under

the provisions of Section 6213 of the Internal Revenue Code of 1954 [R. 6-11, 13-19, 22-27]. The cases were consolidated for trial [R. 78]. The decisions of the Tax Court were entered on July 21, 1959 [R. 67-69]. The cases are brought to this Court by petition for review filed with the Tax Court within three months thereafter [specifically on October 19, 1959—R. 76] and served on respondent [R. 76-77]. Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954. The returns in respect of which the alleged liabilities arise were filed in 1951 and 1952 in the office of the then Collector of Internal Revenue, in Los Angeles, California [R. 75-76].

Questions Presented.

This case involves the unfortunate incident of transactions among and between a family corporation and several family members resulting in corporate expenditures the deduction of which has been disallowed and the payment of which is claimed to constitute a dividend. The questions presented are (i) whether the corporation is entitled to deduct an amount which it agreed to pay to certain family members (owning a majority interest in the Company) in reimbursement of an amount which they had paid for the benefit and protection of the Company (to rid the Company of pernicious domination by another family member having complete control of the Company by reason of a trust) and (ii) whether the reimbursement thereof and the related purchase of the shares of such other family member were distributions essentially equivalent to a dividend.

Statutes Involved.

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *Trade or business expenses.*—

(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, . . .

* * * * * * * *

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, . . .

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter . . . means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits . . .

* * * * * * * *

(26 U. S. C. 1952 ed., Sec. 115.)[1]

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[1]As discussed hereinafter, if it be determined that no unreported dividend income was received by petitioners Baker in 1951, the other adjustments (for omitted interest income and disallowed auto expense) made by respondent are barred by Section 275(a) of the Internal Revenue Code of 1939, three years having elapsed after the filing of their return for 1951 prior to the assessment.

Statement of the Case.

Schalk Chemical Company was incorporated under laws of California in 1903. Since that time it has, and now is, engaged in the business of manufacturing and distributing a line of associated paint and home repair products [R. 96-97; Exs. 13 and 14].

For a period of twenty years, from December 29, 1930, to December 29, 1950, the outstanding stock (then 100,000 shares) of the Company was the principal asset of a spendthrift trust. The beneficiaries were of one family.

Under the terms and designations in the trust instrument entered into when the children were minors, a son (Horace O. Smith, Jr.) having only a 16⅔% beneficial interest in the trust and having little business experience succeeded in 1943 to the office of "Supervisor" of the trust, which office carried with it the extraordinary right to vote all the shares of the Company and to exercise absolute power and control over the management and policies of the Company [Ex. 1, pp. 3 *et seq.*]. In his management of the Company, Smith followed the example set by the (non-family member) Supervisor who preceded him. The other beneficiaries of the trust. Smith's mother (petitioner Hazel I. Farman, owning a 50% beneficial interest) and his two sisters (Evelyn Smith Marlow and petitioner Patricia Baker, each owning a 16⅔% beneficial interest), were given no voice or right to participate in the management of the Company, and his predecessor's policy of preservation of the status quo, nonexpansion and nondevelopment of new products was continued. As Supervisor of the trust and as director and President of the Company and through

the officers and directors whom he elected and controlled,[2] Smith dominated the Company until 1948.

Commencing in 1945 controversies arose between Smith and the other members of the family concerning his management and policies in respect of the Company, and concerning in particular, among other things: Smith's failure to institute and implement any product development program; his inaction in meeting market trends and increased competition; his refusal to raise prices to offset rising labor and material costs; and his rejection of needed expansion of the Company's Chicago facilities (at which 80% of the Company's manufacturing is done) [R. 118-126, 137-148, 156-165, 241-242, 244-245, 299, 308, 353-356].

The other beneficiaries of the trust and members of the family believed that Smith's policies and management, particularly in the critical post-World War II period, were adverse to the best interests of the Company and were endangering its future.

Several proposals were made to settle the controversies by realignment of control [R. 150-151, 173, 413]. An executive committee was established in 1945 to manage the Company but was not permitted to function [R. 129-130, 148-149; Exs. 15; J, p. 271]. Smith continued to exercise his unlimited powers.

In 1947 Mrs. Marlow and Mrs. Baker filed suit to remove Smith as Supervisor of the trust [Ex. 2].

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[2]Hazel I. Farman was a "minority director" of the Company by virtue of the trust instrument. Petitioner Gerald I. Farman, whom Mrs. Farman married in 1931, was appointed a "minority director" in 1945 by Smith's sisters, pursuant to the power to designate one director reserved to them in the trust instrument [Ex. 1, p. 5].

During 1947 the Company experienced substantial operating losses [Exs. 9, 11].

A settlement was reached finally in January, 1948, pursuant to which Smith resigned as Supervisor of the trust and as director and President of the Company and caused the resignations of the directors and officers whom he controlled [Ex. 16].

Concurrently with and in consideration of Smith's execution of the agreement, the other beneficiaries paid $25,000 to Smith with funds that they borrowed [Exs. 19, 20, 21, 36]. At the termination of the trust on December 29, 1950, the Company accepted an assignment of the settlement agreement [Exs. 5, 23] and, in February, 1951, in pursuance of the assignment, reimbursed the individuals for the $25,000 which they had paid to Smith and for interest incurred thereon [Exs. 25, 26, 27]. Upon distribution of the trust estate, the Company paid $20,000 to Smith for the property distributed to him, consisting of 16,666 shares of the Company and other properties [Exs. 6, 7, 8, 24]. The trust estate was distributed in March, 1951 [Ex. 8]. The 16,666 shares acquired from Smith are held by the Company in its treasury.

The amounts so paid by the Company in 1951 were accrued on its books in 1950 and deducted on its return for that year [Ex. A]. Individual petitioners did not report the amount received by them in 1951 in reimbursement of their respective share of the $25,000 paid to Smith nor any amount in respect of the $20,000 which the Company paid to Smith.

Respondent disallowed the deductions taken by the Company in 1950 and charged the individual petitioners with dividend income in 1951 by reason of the forego-

ing transactions.[3] The decisions of the Tax Court sustain respondent.

Petitioner Schalk Chemical Company has conceded that it is not entitled to deduct the $20,000 paid to Smith in 1951 for his share of the trust property [R. 56].

Additional adjustments were made in the 1951 return of petitioners Baker for omitted interest income and disallowed auto expense. These adjustments were not contested in the Tax Court. However, unless petitioners Baker omitted dividend income from their 1951 return such additional adjustments are barred by Section 275(a) of the Internal Revenue Code of 1939.

Specification of Errors to Be Urged.

1. The Tax Court erred in holding that the Company was not entitled to deduct the $25,000 which it agreed to pay to Hazel I. Farman, Patricia Baker and Evelyn Marlow in reimbursement of the $25,000 previously paid by them to Smith.

2. The Tax Court erred in holding that the $25,000 was not paid to Smith on behalf of the Company and for its benefit and the preservation and protection of its business.

3. The Tax Court erred in failing to hold that the $25,000 was paid to Smith on the Company's behalf and for its benefit and the preservation and protection of its business in order to free the Company from the absolute control which Smith, a minority owner, had and exercised over the Company by virtue of the extraordinary

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[3]The 1950 deficiency assessed against the Company is $15,087.22. The 1951 deficiencies assessed against petitioners Farman and Baker are, respectively, $11,589.98 and $2,465.86.

trust powers which he possessed, in failing to hold that the majority owners had reasonable grounds for believing that removal of Smith and his management was essential to protect and preserve the Company, and in failing to hold that in similar circumstances persons of ordinary prudence would have acted in similar fashion.

4. The Tax Court erred in holding that the Company was not morally obligated to reimburse Hazel I. Farman, Patricia Baker and Evelyn Marlow for the $25,000 paid by them to Smith.

5. The Tax Court erred in holding that the Company was not entitled to deduct in 1950 as a business expense the amount which it agreed to pay to Hazel I. Farman, Patricia Baker and Evelyn Marlow to compensate them for interest incurred in borrowing the $25,000 paid to Smith.

6. The Tax Court erred in holding that the payment of $25,000 made by the Company to Hazel I. Farman, Patricia Baker and Evelyn Marlow in 1951 constituted a dividend to petitioners Hazel I. Farman and Patricia Baker in that year, to the extent that they participated in the payment.

7. The Tax Court erred in holding that the payment of $20,000 made by the Company to Smith in 1951, for his share of the trust estate, constituted a distribution essentially equivalent to a dividend to the remaining shareholders of the Company pro rata, including petitioners Hazel I. Farman and Patricia Baker.

8. The Tax Court erred in holding that the payment of $20,000 made by the Company to Smith in 1951, for his share of the trust estate, discharged a contractual obligation of the remaining shareholders.

Summary of Argument.

The tax laws permit the deduction of disbursements made to protect and preserve a business. The $25,000 was paid to remove Smith from control of the Company. By virtue of the trust his power to control the Company was absolute although he was only a one-sixth beneficial owner. In form the transaction was between Smith and the other beneficiaries. But it was the only means available to the latter to protect the Company. Smith would not relinquish control under any other arrangement, with the Company or otherwise. Because of the Company's financial condition and the detrimental effect which Smith's management was having on the Company, the other beneficiaries believed that they could not risk waiting three years until termination of the trust and the expiration of Smith's power. They paid the $25,000 to Smith in order to preserve and protect the Company and their interests therein.

Their action was in substance action which the Company would have taken but for Smith's control. The Company was morally obligated to make reimbursement for the expense and is entitled to a deduction therefor.

Neither the reimbursement nor the eventual purchase by the Company of Smith's share of the trust assets upon distribution of the trust resulted in any true economic benefit to the individual petitioners. No stock or right to stock was acquired by them from Smith. Company funds were not used to satisfy any valid obligation of the individual petitioners. The trust was a spendthrift trust and the purported agreement for the purchase and sale of Smith's future share of the trust assets upon distribution of the trust was unenforceable against the individual petitioners as a matter of law.

The individual petitioners, having paid the $25,000 to Smith for the benefit of the Company, are not chargeable with receiving a dividend by reason of reimbursement of the money. Nor are they chargeable with a constructive dividend by reason of the Company's purchase of Smith's share of the trust assets upon distribution of the trust, no obligation of theirs having been satisfied by the purchase.

The Tax Court rests its opinion on the form, rather than the substance and legal effect, of the transaction with Smith. The cases relied on by the Tax Court are distinguishable.

ARGUMENT.

I.

It Is Well Established That a Disbursement Made to Protect or Promote a Taxpayer's Business Is Deductible.

A. The Courts and the Tax Court Repeatedly Have Allowed Deductions for Disbursements of Such Nature.

In *A. King Aitkin,* 12 B. T. A. 692 (1928), two members of a partnership bought the partnership interest of a third partner whose conduct was jeopardizing the firm. They paid him $5,000 in excess of the value of his partnership interest. The $5,000 was allowed as a business expense of the partnership. (The *Aitkin* case was followed in *Charles F. Mosser,* 27 B. T. A. 513 (1933).)

In *Olympic Harbor Lumber Co.,* 30 B. T. A. 114 (1934), affirmed 79 F. 2d 394 (9 Cir. 1935), it was held that of the sum of $7,900 paid in a transaction which involved the acquisition of assets at least $5,400 was paid to get rid of an unsatisfactory contract and that not more than $2,500 was for the assets taken over. Deduction of the $5,400 was allowed.

In *Helvering v. Community Bond & Mortgage Corp.,* 74 F. 2d 727 (2 Cir. 1935), the Mortgage Company entered into an agreement with another corporation under which the latter became the exclusive selling agent for the former's securities. The arrangement became harmful and embarrassing to the former because of the methods employed by the latter. The Mortgage Company purchased all the outstanding stock of the other corporation and caused its dissolution. It was held that the $30,000 paid for the stock was deductible.

In *First National Bank of Skowhegan,* 35 B. T. A. 876 (1937), the bank paid $10,000 to an out-of-town bank in consideration of the latter's taking over the assets and assuming the liabilities of a local state bank which was about to be closed. It was held that the $10,000 was an ordinary and necessary business expense incurred for the protection of the bank's business, its depositors and its shareholders.

In *Dunn & McCarthy, Inc. v. Commissioner of Internal Revenue,* 139 F. 2d 242 (2 Cir. 1943), payments to employees in repayment of loans made by them to the company's president, who died insolvent, were held to have been made to preserve the good will of the company, and deduction was allowed.

In *Boulevard Frocks, Inc.,* T. C. Memo. Dec. (1943), amounts paid by a company to buy up the employment contracts of certain of its stockholders who were disrupting its business were held to be ordinary and necessary business expenses, to preserve, promote and protect the company's business.

In *Catholic News Publishing Co.,* 10 T. C. 73 (1948), the company's business and reputation were threatened by a controversy between its president and third parties

involving a personal claim asserted against the president. The company's board of directors fearful of further injury to the company's business and reputation directed the president to settle the claim. He did so personally and was reimbursed by the company. The reimbursement was held to be an ordinary and necessary expense deductible by the company.

In *The Stuart Company,* 195 F. 2d 176 (9 Cir. 1952), the company entered into a settlement agreement under which it was obligated to pay $197,700 to another corporation. It was held that $75,000 of the $197,700 constituted a deductible obligation incurred to secure cancellation of an onerous contract and that the remaining $122,700 was allocable to the purchase of a trademark and not deductible.

In *Pressed Steel Car Co.,* 20 T. C. 198 (1953), an expenditure of $375,000 to acquire the stock of another corporation having a burdensome contract with the company was allowed as a business expense.

In *Capitol Indemnity Ins. Co. v. Commissioner of Internal Revenue,* 237 F. 2d 901 (7 Cir. 1956), the company in consideration of cancellation of an agency agreement assumed an obligation undertaken by the agent to repay purchasers of the company's "Founder's Stock" the full amount they had paid for the stock. The agency agreement made it impossible for the company to operate profitably. Payments made by the company to repurchase its "Founder's Stock" were held deductible as ordinary and necessary business expenses.

In *Alleghany Corporation,* 28 T. C. 298 (1957), costs of contesting some, and successfully proposing other, reorganization plans affecting its stock interest in a bankrupt railroad were held to have been incurred to protect the company's business, and deduction was allowed.

According to the foregoing cases, it is immaterial to deductibility that the expense involves a payment to shareholders (*Boulevard Frocks, Inc., supra; Capitol Indemnity Ins. Co. v. Commissioner of Internal Revenue, supra*), that the transaction takes the form of a purchase of assets (*Olympic Harbor Lumber Co., supra; Helvering v. Community Bond & Mortgage Corp., supra; Pressed Steel Car Co., supra; Capitol Indemnity Ins. Co. v. Commissioner of Internal Revenue, supra*), that the transaction is for the protection of an existing investment (*Dunn & McCarthy, Inc. v. Commissioner of Internal Revenue, supra; Alleghany Corporation supra;* compare *Rittenberg v. United States,* 267 F. 2d 605 (5 Cir. 1959))), or that the actual expenditure is in reimbursement of a payment made by another person on behalf of the company (*Catholic News Publishing Co., supra*).

B. The $25,000 Was Paid to Preserve and Protect the Company.

Petitioners contend that the $25,000 was paid to Smith to secure his resignation as Supervisor of the trust and as director and President of the Company and the resignation of the directors and officers whom he controlled. Assuming for the purposes of this argument, but without any concession on petitioners' part as to the substance or effect of the actual transaction, that the Company had paid $25,000 to Smith in consideration of his resignation as Supervisor, the payment would have been deductible.

For one thing, promotion of harmony in the conduct of a business is a proper corporate business purpose.

Fred F. Fischer, T. C. Memo. (Dec. 1947); *Gazette Pub. Co. v. Self,* 103 Fed. Supp. 779 (E. D. Ark. 1952). There was more here, however, than elimination of internal strife affecting the Company's operations. Competition in the Company's specialty field had multiplied many times following the end of World War II. Newer and easier to use products had come on the market. In the opinion of the other beneficiaries, the Company under Smith's management was not keeping, and was not attempting to keep, pace with competition, either in products or other matters, such as trade discounts.

The Company had eight products on the market in 1947 [R. 96]. The Company had started in 1903 with "Hydro Pura." "Savabrush" was added in 1920 and the Company's mainstay item, "Double X," was added in 1924. The remaining five were put on the market, respectively, in 1932, 1937, 1940, 1946 and 1947, the last two through the efforts of petitioner Gerald I. Farman, with Smith's reluctant blessing. These products all were in powder form, and although competitors were introducing comparable products in liquid form which were easier to use Smith refused to supplement the Schalk line with like products.

The need for new and improved products was noted during Curtis C. Colyear's tenure as Supervisor. A memorandum from H. C. Lieben to Colyear dated January 25, 1941 [Ex. J, p. 221], by way of explanation of the loss suffered by the Company in 1940, states:

> "While our other specialty items have either held their own or enjoyed an increase, Double X Floor Cleaner has been declining rapidly since ~~1947~~ 1937. This

has been due primarily to increased competition of lower priced items, use of new floor finishes and increased usage of sanding machines."

"Double X" was the Company's leading article in money and sales value. It was the item with which the Company's salesmen could do the biggest volume. In 1937 sales of "Double X" totalled $104,209. By 1940 sales of this product had declined to $78,000. Sales of "Hydro Pura" had dropped to $14,363 by 1939, as compared with a peak of $270,244 in 1922.

The adverse trend in the Company's business was suspended by the war. Smith's management rode along with the false economy, with no research and development program, and with no plans for meeting problems which it was obvious would beset the Company after the war. Smith admitted that the Company should have had a research and development program [R. 373, 406].

Labor and material costs greatly increased [R. 87], but until the change in management in 1948 no price increases were instituted [R. 101-102]. In fact none had ever been made on any of the Company's products.

Operating losses were sustained monthly commencing in February 1947, cumulating to a total operating loss of $32,158.67 in 1947 [Exs. 9, 11; R. 85]. By the end of 1947 working capital was seriously depleted and a bank loan of $20,000 was due in January, 1948 [Exs. 9, 17].

These and other disturbing matters concerning the business, Colyear's management and Smith's management were testified to by petitioner Gerald I. Farman and by Earl F. Bradley, a salesman for the Company for thirty-five years [R. 118-126, 137-148, 156-165, 241-

242, 244-245, 246-254, 299, 308, 353-356], and not contradicted by Smith in any essential respect.

At the time of the settlement, three years remained to run before termination of the trust, during which Smith would have continued to dominate the Company. It is doubtful in view of the Company's financial condition at the end of 1947 whether it could have withstood another loss year, let alone three years.

Management was changed in 1948. Prices were increased [R. 101-102]. Trade discounts were made competitive [R. 103]. The Company's accounts were surveyed and new outlets were secured [R. 166-168]. Nine new competitive products were placed on the market in the period from 1948 to 1956 [R. 97].

Unless there were some real threat to the Company, it is not rational that any amount would have been paid to Smith. His domination of the Company would have ended with the termination of the trust. There was no need to anticipate this fact by a payment of money which he could not have demanded but for the extraordinary power which the trust gave him. The other beneficiaries of the trust automatically would have succeeded to control of the Company at the end of 1950.

The Tax Court, deflected by reliance on the form of the transaction, gave little heed to the surrounding circumstances:

> "We are satisfied that they [the other beneficiaries] thought their participation would be beneficial to the corporation, but we are not convinced that the management of the corporation under Smith was incompetent and that their action was either necessary or desirable to preserve its business." [R. 59.]

This is tantamount to the finding of the Tax Court reviewed in *Levitt & Sons v. Nunan,* 142 F. 2d 795 (2 Cir. 1944). In that case, demand had been made on the corporate taxpayer for an accounting in respect of certain property which it possessed. It was claimed that a shareholder of the company who also was manager of the claimant had obtained the property as the result of an abuse of trust. The claim was settled for $65,000, which was deducted on the theory that it had been paid to avoid unfavorable publicity. Disallowance of the deduction was sustained by the Tax Court on the ground that "the anticipated injury to the business was not certain to occur." The Second Circuit held this to be a wrong interpretation of the statute, stating:

> "That such payments to protect a business generally are 'ordinary' expenses is abundantly settled by authority and can no longer be questioned . . . they are altogether normal. Whether they are 'necessary' depends upon the questions on which the Tax Court did not pass, because of its misconception of the statute. . . . An expense to avoid such results [damage to credit and reputation] may be 'necessary', although the anticipated loss is not inevitable; *business, like everything else, can only be conducted upon prophecies, and prophecies are never infallible.* If in the case at bar the Levitts were right in thinking that Edelman's suit would be likely to have those effects upon its credit which they expected, that was enough; 'necessary' in this connection only means necessary, if reasonable expectation proves well grounded." (142 F. 2d at 798.)[4]

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[4]Emphasis in quoted material added throughout unless otherwise noted.

According to *C. Ludwig Bauman & Co. v. Marcelle,* 203 F. 2d 459 (2 Cir. 1953), at page 462, "good faith business judgment" is the test of "necessary."

And, as stated in *Welch v. Helvering,* 290 U. S. 111 (1933), at 115:

> "The standard [ordinary and necessary expenses] set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle."

If taxpayers were to have the burden of *"convincing"* the Tax Court that an expenditure to preserve, protect or promote their business was "necessary or desirable," such expenses would never be allowed. The proper test in this instance was whether there existed reasonable grounds for believing that if a change in the management of the Company were not effected prior to termination of the trust the Company might fail or become wasted to an extent from which it could not recover. In petitioners' opinion, reasonable grounds existed for the belief that the Company was likely to suffer irreparable damage if a change in management were not effected prior to determination of the trust. Expenditure of $25,000 to secure the change in management falls within the statutory test of "ordinary and necessary."

C. The Company Was Obligated to Make the Reimbursement.

If form be disregarded—and it must be—it is evident that the $25,000 was paid for the benefit and protection of the Company and the Company became morally obligated to indemnify the other beneficiaries, not only for the $25,000 which they paid to Smith but also for the interest they incurred in borrowing the money. The Com-

pany met its obligation by the 1950 assignment agreement [Ex. 23] and the payments which it made in 1951.

It is settled law that a moral obligation is sufficient consideration for a subsequent promise. *Fraser v. San Francisco Bridge Co.,* 103 Cal. 79, 36 Pac. 1037 (1894). Moreover, deductibility of an expense is not affected by the fact that it is predicated on a moral obligation.

As stated in *Abraham Greenspon,* 8 T. C. 431 (1947):

> ". . . even if the obligation, springing as it did from a business transaction, were only a moral obligation, we do not understand that fact of itself would preclude a deduction." (8 T. C. at 434.)

In *Catholic News Publishing Co.,* 10 T. C. 73 (1948), which is discussed above in Part A, the Tax Court stated:

> "The manner of effecting settlement appears to us to be a matter of complete indifference. That is to say, the fact that Ridder [the company's president] first used his own funds to pay the association and was reimbursed by the petitioner in equal amount calls for no different result than if petitioner had made direct payment to the association or, in the first instance, had given Ridder the money to turn over to the association. And, even if there was no express understanding, petitioner was certainly obligated in equity and good conscience to reimburse Ridder, cf. *Gilt Edge Textile Corporation,* 9 T. C. 543, in view of the fact that it had directed him to settle a claim for which he denied all personal liability and which he would not otherwise have paid." (10 T. C. at 76-77.)

The Tax Court, however, found such cases to be inapplicable here because:

> ". . . Schalk did not authorize them [the other beneficiaries] to act, formally or informally, and it was not obligated, morally or legally, to reimburse them for the $25,000 they paid pursuant to the terms of the settlement agreement." [R. 59.]

II.

The Tax Court's Determination Rests on the Form, Rather Than the Substance and Legal Effect, of the Transaction With Smith.

The Company was not named as a party to the settlement agreement with Smith. The agreement was between Smith and the other beneficiaries of the trust. They, not the Company, borrowed and paid the $25,000 to Smith. The minutes of the meetings of the pre-January 15, 1948 board of directors dominated by Smith contain no authorization or direction that the other beneficiaries act on the Company's behalf in dealing with Smith. The trust agreement placed complete control of the Company in Smith.

These facts constitute the principal ground on which the Tax Court premised its opinion:

> "The parties to the settlement agreement were in fact the other beneficiaries and Smith. Schalk was not a party to, and did not authorize the other beneficiaries to enter into, the agreement. Petitioners' argument . . . is without merit. Their reasoning is that . . . their action was in substance the action of Schalk. This reasoning overlooks the fact that the trust agreement, which created their beneficial interests, placed complete control of

Schalk in Smith, the supervisor of the trust, and prevented them from acting for or on its behalf." [R. 58.]

"In any event, Schalk did not authorize them to act, formally or informally, and it was not obligated, morally or legally, to reimburse them for the $25,000 they paid pursuant to the terms of the settlement agreement." [R. 59.]

"As already noted, Schalk was not a party to the settlement agreement, did not authorize the payment, and was not obligated, legally or morally, to reimburse them therefor. Its action in reimbursing them for the payment was, therefore, voluntary, and . . . the distribution constituted a dividend. . . ." [R. 63.]

A. Taxation Should Depend on Substance, Not Form.

In *Landa v. Commissioner of Internal Revenue,* 206 F. 2d 431 (D. C. Cir. 1953), the Tax Court rejected oral testimony offered to support the deductibility of payments to a former wife as alimony. The written agreement in question described the payments as installments of principal and interest on a note in favor of the wife. In reversing the Tax Court, the District of Columbia Circuit stated:

"Generally, '[i]n the field of taxation, administrators of the laws, and the courts, are concerned with substance and realities, and formal written documents are not rigidly binding.' The taxpayer as well as the Commissioner of Internal Revenue is entitled to the benefit of this rule." (206 F. 2d at 432.)

In a subsequent appeal in the same case, 211 F. 2d 46 (D. C. Cir. 1954), the District of Columbia Circuit again reversed the Tax Court, stating:

> "The purpose of this rule [quoted above] is manifest. Whenever taxation is allowed to depend upon form, rather than substance, the door is opened wide to distortions of the tax laws which, after all, represent the legislative judgment for an equitable distribution of the tax burden generally. Clearly, this purpose is not advanced by applying the rule only if it serves to increase the tax in the particular case." (211 F. 2d at 50.)

In *Jennings v. United States,* 272 F. 2d 842 (7 Cir. 1959), a corporation made payments to its majority shareholders which it charged against "contributed or paid-in surplus." Previous to the distributions, loans made to the corporation by the shareholders had been removed from a liability account and credited to the same surplus account. It was held, notwithstanding the entries, that the distributions were repayments of loans, and not dividends, because it was so intended.

B. The Form of the Settlement Was Dictated by Smith and the Other Beneficiaries Had No Choice.

As found by the Tax Court:

> "During the course of the negotiations leading to the settlement agreement, the other beneficiaries of the trust proposed that the settlement be by agreement between Smith and Schalk. Smith *rejected* their proposals that Schalk be a party to the agreement or pay any part of the money which he was demanding. He *insisted* upon dealing directly with the other beneficiaries." [R. 46-47.]

Henry D. Wackerbarth, Smith's attorney, testified:

"Q. [Mr. Hall] Now, is it your testimony that Mr. Guthrie and Mr. Olson did not propose that the money be paid by the corporation to Mr. Smith? A. Is it my testimony that they did not propose that?

Q. Yes. A. No. That is not my testimony.

Q. That was their proposition? A. That was their proposition.

Q. And that was over many months of this negotiation, was it not, their proposition? A. How long I can't say, but it was never accepted, if that means anything.

Q. Sure. In other words, from your side of the picture, and Mr. Smith's side of the picture, you were insisting that it be between the family members? A. That is correct.

Q. Is that correct? A. That is correct.

Q. And on Mr. Guthrie's side, and the family's side, they were trying to work it out so that the corporation would pay the money to Smith, rather than the individuals? A. That is correct." [R. 452-453.]

The point is summed up in this excerpt from the testimony of Milo V. Olson, who assisted Stanley W. Guthrie in representing the other beneficiaries of the trust:

"If you state settlement, Mr. Smith would only settle on the basis which was set forth in the agreement that was finally executed. . . .

"As I understand, the [sic] settlement, your choice is what the other party is willing, finally willing to do. . . . The family could have continued to litigate. They did have that choice, but we chose to settle." [R. 390.]

C. The $25,000 Was Paid for Smith's Entering Into the Settlement Agreement and Relinquishing Control of the Company.

The Tax Court erroneously interpreted the settlement agreement as providing that the $25,000 was a "down payment" on the purchase price of Smith's share of the trust property at the time of termination and distribution of the trust [R. 61].

The agreement was skillfully drawn to Smith's and his attorney's specifications.

It first provides that in consideration of the sum of $25,000 then paid, Smith agrees to sell to the other parties upon termination and distribution of the trust all his right, title and interest in the corpus and any accumulations [Ex. 16, pp. 1-2]. Within 30 days after actual distribution of the trust, the other parties agree to pay to Smith $20,000 [*Ibid.* p. 2].

Then follows this language:

> "It is understood and agreed that this agreement shall not be intended or construed as an assignment or transfer by First Party [Smith] of any present right, title or interest of First Party in or to said trust . . . and that no transfer of any interest of First Party in or to said trust . . . shall be made by First Party until said trust has terminated and the corpus . . . shall have been distributed to First Party." [*Ibid.* p. 2.]

The succeeding four paragraphs include provisions for an escrow at the time of distribution of the trust (*Ibid.*, pp. 2-4).

It is then provided commencing on page four:

"In consideration of First Party agreeing to resign as supervisor of the trust hereinbefore described and as officer and director of Schalk Chemical Company, a corporation, and of his securing the resignation of Henry O. Wackerbarth as an officer, director and attorney for said corporation, and of H. T. Rausch as a director and auditor of said corporation, the parties hereto agree to enter into a stipulation for the entry of a judgment in the action in the Superior Court of the State of California in and for the County of Los Angeles, entitled Evelyn Smith Marlow and Patricia Farman Baker, as Plaintiffs, vs. Union Bank and Trust Co. of Los Angeles, a corporation, et al, as Defendants, and numbered 528,107 in said Court, which said stipulation is being entered into concurrently herewith.

"In the event that Second Parties, their heirs, successors, or assigns, shall fail, neglect or refuse to pay the balance of the purchase price as herein provided, First Party shall be released from any and all obligation to sell, transfer, convey or assign the property herein described, and Second Parties, their heirs, successors and assigns, shall be released of any and all obligations to purchase said property or to pay to First Party any additional moneys hereunder.

"The entire purchase price for the property herein agreed to be sold by First Party to Second Parties shall be the sum of $45,000.00, less any distribution made by First Party from said trust as herein provided, and the sum of $25,000.00 paid by Second

> Parties *as consideration to First Party for entering into this agreement* shall, in the event Second Parties, their heirs, successors or assigns, comply fully and promptly with the terms and conditions hereof, be applied towards said total purchase price." [*Ibid.* pp. 4-5.]

The agreement concludes with miscellaneous provisions permitting assignment by "Second Parties," providing for insurance on Smith's life in the sum of $25,000 in favor of "Second Parties" and declaring that time is of the essence and that the agreement shall inure to the benefit of the heirs, executors and assigns of the parties [*Ibid.,* pp. 5-6].

The agreement is artfully ambiguous. It was so designed to give Smith a basis for claiming payments thereunder as capital gains, and not ordinary income, which he did [R. 421].

The true transaction is set forth in Smith's written offer of September 12, 1947 [Ex. 22]. Exhibit 22 clearly identifies the $25,000 as a consideration for Smith's relinquishment of control. Exhibit 16 represents a change in form, not substance.

D. The Settlement Agreement Was Invalid as a Contract for the Purchase and Sale of Smith's Share of the Trust.

The trust involved in this case was a spendthrift trust. Article II, Paragraph (O), of the trust instrument [Ex. 1, pp. 14-15] provides:

> "The beneficiaries of the trust or any trust created hereby or hereunder, are and each of them is, restrained from and they jointly are and each is and shall be without right, power, or authority to

sell, give, transfer, pledge, mortgage, hypothecate, alienate, anticipate, discount, or in any manner to affect or impair their, his or her beneficial legal rights, titles, interests, claims or estate, in and to the income and/or principal of said trust or trusts, during the entire term thereof, or of any thereof, nor shall said rights, interests, titles, claims or estates of said beneficiaries or of any of said beneficiaries be subject or liable to the rights or claims of any creditor of said or of any of said beneficiaries, nor subject to any process of law or court, and all of the net income and/or principal of said trusts or any of them shall be transferable, payable and deliverable only, solely, exclusively and personally to the beneficiaries and each of them and their heirs at law at the time they are, or he or she is, entitled to take the same under the terms of said trust, or of any of them, and the personal receipt of each beneficiary, his or her heirs, hereunder shall be a condition precedent to the payment or delivery of the same by said trustee to said beneficiaries and to each of them.

"Provided, however, if any of such beneficiaries has not attained his or her majority then payment to the guardian of the estate of such beneficiary shall be deemed a payment to the beneficiary and receipt of such guardian be a complete discharge of said trustee."

The trust was created in California. California recognizes spendthrift trusts.

In *McColgan v. Walter Magee, Inc.*, 172 Cal. 182, 155 Pac. 955 (1916), the California Supreme Court stated:

> "The general doctrine that spendthrift trusts, inalienable by the beneficiary and inaccessible to his creditors during his life or for a term of years, are valid in this state, is well established." (172 Cal. at 186.)

A beneficiary of a spendthrift trust may not dispose of his interest in the corpus. *Kelly v. Kelly,* 11 Cal. 2d 356, 79 P. 2d 1059 (1938); *Estate of Madison,* 26 Cal. 2d 453, 159 P. 2d 630 (1945).

As stated in *Kelly v. Kelly, supra*:

> "It is of the essence of a spendthrift trust that it is not subject to voluntary alienation by the *cestui* . . . But it is everywhere agreed that after the beneficiary has actually received the trust property . . . he may dispose of it as he wishes." (11 Cal. 2d at 362.)

California, however, recognizes that the beneficiary of a spendthrift trust may contract to assign the trust property when and if received by him. But such an assignment gives the assignee no right in specific trust property received by the beneficiary.

The rule is declared in *Kelly v. Kelly, supra:*

> "But although it cannot be held that the beneficiary, upon receipt of trust property, in turn holds said specific property, or its proceeds, in trust for his assignee under an assignment made prior to his receipt of the trust property . . . we are of the view that an assignment by the beneficiary, in the nature of a promise to pay or turn over trust prop-

erty when received by him, is *not* wholly invalid. Although such an assignment or promise gives the promisee *no right in specific trust property received by the beneficiary, or in its proceeds,* such promisee has available to him the usual remedies for breach of contract and may sue to recover damages for breach of said contract, in which the damages will ordinarily be the value of the property the promisee would have received had the beneficiary performed his promise to turn over a fraction of the trust property upon its receipt." (11 Cal. 2d at 363-364.)

The California rule was recognized in *Century Indemnity Co. v. Woodruff,* 119 Fed. Supp. 581 (N. D. Cal. 1954), although in that case an assignment of an interest in a spendthrift trust was held totally unenforceable under applicable Illinois law.

In so far as the settlement agreement pertained to Smith's trust interest, it was ineffectual except as a contract to assign.

The other beneficiaries of the trust, therefore, were not obligated to purchase the property distributed to Smith upon termination of the trust but had a possibility, if they or their assigns desired to do so, of acquiring such property, provided Smith survived termination of the trust and chose to comply with his promise. Such contingent right was less than an option, since the right could not be specifically enforced. No capital asset or right to a capital asset was acquired by virtue of the settlement agreement [Ex. 16] or the assignment agreement [Ex. 23].

III.

No Unreported Dividend Income Was Realized by the Individual Petitioners in 1951.

The circumstances surrounding the settlement with Smith compel the conclusion that the other beneficiaries intended to act to protect and preserve the Company and believed that a change in management was imperative for the reasons discussed above in Part I. The Tax Court was "satisfied" that the other beneficiaries "thought" a change in management and policies would be beneficial to the Company [R. 46, 57, 59].

The personal benefits stressed by the Tax Court [R. 59] which might accrue to the other beneficiaries as income beneficiaries of the trust and later as shareholders, if the anticipated betterment of the Company materialized, are beside the point. The other beneficiaries believed that Smith's management was endangering the ability for the Company to continue as a going concern. To wait for termination of the trust and automatic cessation of Smith's control might have been fatal. Since Smith was unwilling to do anything tangible to remedy the apparent deficiencies in his management, the only recourse of the other beneficiaries was to induce Smith to relinquish control in advance of termination of the trust. The litigation had not progressed beyond the demurrer stage and might have become moot by reason of termination of the trust prior to final determination.

The other beneficiaries realized no gain or loss from the transaction with Smith and reimbursement by the Company. They had to borrow the $25,000 which was paid to Smith [R. 186; Exs. 19, 20, 21, 36]. They had no desire or reason to want to acquire Smith's one-sixth interest in the corpus of the trust [R. 174, 330]. The

objective was to relieve the Company of domination by Smith. Smith, for personal reasons, coupled his agreement to relinquish control of the Company with a purported agreement for the purchase and sale of the trust property due him upon termination and distribution of the trust.

In the language of the Eighth Circuit in *Tucker v. Commissioner of Internal Revenue,* 226 F. 2d 117 (8 Cir. 1955), at page 179:

> "This is not a case where one in control of a corporation has, under the pretense of corporation action, siphoned off its profits for purely personal purposes."

The $25,000 "blood money" [R. 183] which Smith demanded was paid by the other beneficiaries as a temporary expedient, with the expectation that when able to do so the Company would repay them [R. 185-187, 331]. By the end of 1950, the Company was able to make the repayment.

Observing the substance, and not the form, of the transaction, the Company in reality paid the $25,000 to Smith for a proper corporate business purpose with funds borrowed by the other beneficiaries and loaned to the Company.

Analogous circumstances existed in *Fox v. Harrison,* 145 F. 2d 521 (7 Cir. 1944). The president of a corporation, owning two-thirds of its stock, was heavily indebted to the corporation. He sought to liquidate his indebtedness by surrender and retirement of a portion of his stock. When advised that this could not legally be done, he threatened to liquidate the corporation, unless his stock were purchased at par. The corporation was

not financially able to purchase the stock. Fox, owning the remaining one-third of the stock, unsuccessfully endeavored to borrow money for the corporation. He then borrowed money on his own credit and purchased the stock interest of the president. When it was able to in a subsequent year the corporation purchased the stock which Fox had thus acquired, at the price he had paid for it. In holding that the distribution was not essentially equivalent to a dividend, the Seventh Circuit stated:

> ". . . [The Government's] theory is apparently predicated upon the mere form of the transaction, without giving consideration to the substance. In reality, the involved stock was purchased by the corporation from Cross. That the purchase was not made directly from him was due to the inability of the corporation readily to finance such purchase. Appellee merely supplied the security by which the finances were obtained. The very checks which he received for the stock when it was turned over to the corporation were used in payment of the loan which he had obtained from the bank. He realized no gain or profit on the transaction. His relation to the transaction is very aptly described by the District Court:
>
> '* * * that Fox was acquiring said stock on behalf of the corporation and as a temporary expedient, and that when the corporation should accumulate a sufficient surplus and should have available funds, it would take the stock off of Fox's hands. He had no desire or purpose to make a permanent, personal investment in the Cross stock.' " (145 F. 2d at 522-523.)

Certainly the other beneficiaries received no dividend income by reason of the Company's payment of $20,000 to Smith in 1951 for his share of the trust property. As discussed above in Point II, Part D, the settlement agreement was invalid and unenforceable except as a contract on Smith's part "to assign" his share of the trust property upon termination of the trust, for the breach of which he might have been held for damages. *Kelley v. Kelly,* 11 Cal. 2d 356, 79 P. 2d 1059 (1938). No right to such future property was acquired. All that the other beneficiaries and the Company acquired by reason of the settlement agreement and its assignment to the Company was the possible right, if desired, to purchase Smith's share of the trust property, if he survived termination of the trust and chose to honor the agreement. Such contingent right was less than an option, since it was not specifically enforceable.

The assumption and exercise of such right by the Company did not result in dividend income to the individual petitioners. *Holsey v. Commissioner of Internal Revenue,* 258 F. 2d 865 (3 Cir. 1958), so holds. Holsey owned 50% of the stock of a corporation and held an option to purchase the other 50%. He assigned the option to the corporation. The corporation exercised the option and purchased the stock at the option price. The Third Circuit held that distribution was not taxable to Holsey as a dividend.

The Internal Revenue Service has announced that it will follow the *Holsey* decision (Technical Information Release 109 (1958); Rev. Rul. 58-614, 1958-2 CB 920).

Rev. Rul. 58-614 states:

> "In the future, the Service will not treat the purchase by a corporation of one shareholder's stock as

a dividend to the remaining shareholders merely because their percentage interests in the corporation are increased."

Note also should be taken of the following cases and rulings:

In *Ray Edenfield,* 19 T. C. 13 (1952), the taxpayer and his associates purchased part of the shares of a corporation and, concurrently, it was arranged to have the remaining outstanding shares redeemed by the corporation. The payments made in redemption of the stock were held not to constitute dividends to the taxpayer. The Internal Revenue Service has acquiesced in this decision (1953-1 CB 4). (Compare Rev. Rul. 54-458, 1954-2 CB 167.)

In *John A. Decker,* 32 T. C. 331 (1959), five individuals owning all of the stock of a corporation entered into an agreement that upon the death of any of them, the survivors would buy his stock at book value. One stockholder died in 1953, another in 1954. The survivors purchased the stock of each decedent and immediately transferred the stock to the corporation for the same price. In holding that the distribution was not essentially equivalent to a dividend, the Tax Court stated:

> *"Petitioners did not receive any true economic benefit from the transactions when considered as a whole.* They had the same amount of cash and the same number of shares of stock after the transactions were completed as they had before the death of the deceased stockholder. Their stock represented a higher percentage of equity in the basic assets of the company, but those basic assets were reduced proportionately so the stock actually represented the

same value, assuming that the book value for which the stock was bought and sold represented the value of the underlying assets. So petitioners gained nothing from the distribution unless it is that the use of company funds to meet their obligations under the stock purchase agreement produced an economic benefit for them.

"Respondent relies principally on this argument that corporate funds were used to satisfy the personal obligations of petitioners under the stock purchase agreements and, therefore, the payments were essentially equivalent to dividends, citing Wall v. United States (C. A. 4), 164 F. 2d 462 [36 AFTR 423], and Ferro v. Commissioner, (C. A. 3) 242 F. 2d 838 [50 AFTR 2084], affirming T. C. Memo 1956-94. In both of these cases, the taxpayer was the sole stockholder and had become so by previously incurring the obligation which corporate funds were used to satisfy. There was no corporate business purpose for the corporation to pay these obligations and the only ones benefiting therefrom were the stockholders, and the decision for the corporation to pay the obligation was made several years after the obligations were incurred by the taxpayers.

"In our case, *none of the petitioners ever had complete ownership or control of the corporation,* and we believe there was a sound business reason for the corporation to acquire the stock. While petitioners may have been obligated to purchase the stock of a deceased stockholder, this is a different sort of obligation from those in the Wall, Ferro, and other cases wherein this point has been raised. . . . *The corporation did not pay a pre-existing*

debt of the petitioners, the saisfaction of which would increase their net worths. They realized no economic benefit from the transaction."

In Rev. Rul. 59-286, IRB 1959-36, p. 9, advice was requested whether a stock redemption by a corporation from an estate, the stock having originally been held equally by two brothers, constituted a constructive dividend to the remaining shareholder. The brothers, *B* and *C*, had agreed that upon the death of one of them the survivor would either purchase the decedent's stock or vote his stock for liquidation of the corporation. Upon the death of *C*, the corporation redeemed the shares held by his estate. The ruling states:

"Under the terms of the stockholder's agreement, *B* was personally obligated either to purchase *C*'s stock or to vote his stock for liquidation of the corporation. The corporate action in redeeming *C*'s stock relieved him of his personal obligation under the agreement. However, at no time did *B* purchase the redeemed shares or obligate himself to do so; consequently the instant case is distinguishable from the case of *Wall v. United States*. . . .

* * * * * * *

". . . there is no authority *affirmatively* supporting the proposition that a redemption of one stockholder's shares, at fair market value, constitutes a dividend to a remaining shareholder. . . .

"In the instant case, *B* neither before nor after the redemption can be considered to have possessed the shares of stock redeemed from *C*'s estate. Accordingly, it is held that a redemption by the cor-

poration of the decedent shareholder's shares of the corporation's stock from his estate does not constitute a constructive dividend to the remaining shareholder."

In *Fred F. Fischer,* T. C. Memo. Dec. (1947), the daughter of a deceased officer and stockholder of the Fischer Meat Company to whom stock had been willed held the conviction that the corporation was "not being successfully handled by the present management, and that . . . the expenses and the salaries have been out of proportion. . . ." She threatened to institute receivership proceedings against the corporation and to file suit contesting the deceased's Will and the validity of the trust provided for therein. Petitioner was the son of the deceased and entered into a settlement with his sister under which he agreed to purchase or secure a third party to purchase the sister's stock. Petitioner at the time was director and managing officer of the corporation. The corporation had only two directors. Petitioner and the other director held a meeting and authorized the corporation to purchase the sister's stock for an amount in excess of the fair market value of the stock. The excess was treated by the Commissioner as a payment for the benefit of the remaining stockholders, including petitioner, and taxable to them as a dividend. The Tax Court held for the taxpayer, stating:

> "On this record we cannot agree that the meat company in purchasing Mrs. Rhodes' stock was satisfying a purely personal obligation of the petitioner or the other stockholders and serving no purpose of its own. The undisputed evidence shows that several matters were in controversy. Mrs. Rhodes personally and through her counsel was complaining

of the management and operation of the business of the meat company, of its meager earnings and failure to pay dividends, whereas in the past it had been a great money maker. She threatened to institute receivership proceedings against the company, and she was demanding $275 a share for her stock at a time when the book value was only about $155 a share.

* * * * * * *

". . . the evidence of record here refutes the respondent's contention that a will contest was the only or even the primary matter sought to be settled in the compromise agreement. Furthermore, there is no foundation for an assumption that a corporation would never, in its own interests, pay more than the fair market value of its stock in order to rid itself of a complaining minority stockholder threatening to institute receivership proceedings against it. . . . *If any advantage can be said to have accrued to petitioner from the corporation's purchase of Mrs. Rhodes' stock, we do not think it is of a kind which would justify a holding that any part of the purchase price amounted to a constructive dividend to him.*"

The Tax Court relies [R. 66] on *Wall v. United States,* 164 F. 2d 462 (4 Cir. 1947), *Zipp v. Commissioner of Internal Revenue,* 259 F. 2d 119 (6 Cir. 1958), and *Garden State Developers, Inc.,* 30 T. C. 135 (1958), each of which is distinguishable.

In the *Wall* case, 60 shares of Rosedale Dairy Company were owned by Wall. The remaining 60 shares were owned by Moses. Moses died in 1933. Coleman, principal owner of Rosedale's chief competitor, purchased Moses'

stock. After several years Wall initiated negotiations which culminated in an agreement dated August 28, 1937 under which Wall agreed to buy, and Coleman agreed to sell, Coleman's stock and certain other properties for $71,700, payable $6,700 down, $5,000 annually for nine years and $20,000 in the tenth year. The other properties were valued at $14,700. Wall executed 13 promissory notes each for $5,000. The stock was transferred to Wall and placed in a trust to secure payment of the notes.

Wall paid the down payment and the first note when it became due in 1938. In 1939 Wall entered into an agreement with Rosedale under which Rosedale agreed to pay the remaining notes (aggregating $60,000) in return for Wall's interest in the stock purchased from Coleman which remained in trust.

In 1939 Rosedale paid the second note. This $5,000 payment was held to constitute a taxable dividend to Wall.

The facts distinguishing the *Wall* case from the instant case are:

(i) Rosedale assumed obligations of Wall totalling $60,000, whereas the purchase price of the stock was $57,000;

(ii) The Coleman stock had been transferred to Wall, and "Wall owned or controlled 100 per cent of Rosedale prior to his transfer of his equity in the stock to Rosedale, and he continued to own or control 100 per cent of Rosedale's outstanding stock after the transfer." (164 F. 2d at 465);

(iii) Wall "*deliberately elected* to attain his objective by two distinct transactions. . . ." (164 F. 2d at 466);

(iv) "Wall was not acting on behalf of Rosedale but was induced by personal considerations to purchase the Coleman stock on his account. . . . There was no pressure upon the corporation to buy the Coleman stock in 1937 and no lack of corporate funds with which to make the purchase if it had been deemed desirable." (164 F. 2d at 466); and

(v) "The controlling fact in this situation was that Wall was under an obligation to pay Coleman $5,000 in the tax year and that Rosedale paid this indebtedness for Wall out of its surplus." (164 F. 2d at 464.)

In the *Zipp* case (259 F. 2d 119), all the outstanding stock (50 shares) of the corporation was owned by Zipp and his two sons. Each of the sons owned one share. In 1947 the father transferred 23 shares into the name of each son to place the shares beyond the reach of a new wife. These shares were endorsed in blank by the sons and held by the father. In 1950 the corporation paid the father $93,782.50 in money and property, in consideration of his retirement from participation in the corporation's affairs. The two shares then standing in his name were endorsed by him in blank and surrendered to the company, and he executed a disclaimer of any interest in the 46 shares transferred to the sons in 1947. The Tax Court held that (i) the father did not make a gift of the 46 shares in 1947, (ii) the transaction in 1950 was in effect the redemption of 48 shares owned by the father and (iii) the net effect of the 1950 transaction was that corporate funds were used for the benefit of the sons to purchase 48 shares from the father with the result that the sons were deemed to have received constructive dividends in the amount of the money and property paid to the father.

In contrast to the instant case in which no stock or right to stock was acquired by the other beneficiaries by virtue of the settlement agreement, the sons in the *Zipp* case acquired 46 shares, or 92% of the stock then outstanding, and ended up with a 100% ownership. As pointed out by this Court in *Niederkrome v. Commissioner of Internal Revenue,* 266 F. 2d 238 (9 Cir. 1958):

> "The Zipp holding has been severely criticized. And it has been said that, if there had been no sale to stockholders, a dividend determination could have been avoided by the remaining stockholders." (266 F. 2d at 243.)

(Compare the quotation from Rev. Rul. 58-614, *supra*).

It is true that the *Wall* and *Zipp* decisions are premised to a considerable extent, if not entirely, on the form of transactions which were involved. In each case, however, the taxpayer had a choice with respect to the manner in which the transaction was handled. In such circumstances, the applicable rule, as stated in *Woodruff v. Commissioner of Internal Revenue,* 131 F. 2d 429 (5 Cir. 1942), is:

> ". . . if a taxpayer *has* two legal methods by which he may attain a desired result, the method pursued is determinative for tax purposes without regard to the fact that different tax results would have attached if the alternative procedure had been followed." (131 F. 2d at 430.)

As discussed above in Point II, Part B, the other beneficiaries had no choice. Smith dictated the form of settlement and in so doing exacted what was the most advantageous to him personally.

In the *Garden State* case (30 T. C. 135), a corporation paid off obligations of its stockholders incurred in the purchase of its outstanding stock. The payments were charged as costs of certain land acquired by the corporation pursuant to a corporate contract existing prior to acquisition of the stock by the stockholders. The stockholders were primarily interested in acquiring the land, but the consent of the sellers of the land to an assignment of the corporate contract could not be obtained. They bought the stock of the corporation instead. The Tax Court held that the distinction between the corporation and its individual stockholders could not be disregarded because it was essential to the intended acquisition of the land.

The converse is true here. Acquisition of Smith's interest in the trust was not essential to the intended change of management. Smith's resignation as Supervisor of the trust was all that was necessary. The "agreement of purchase" was imposed by Smith. The other beneficiaries had no desire to purchase Smith's one-sixth beneficial interest in the trust.

Conclusion.

The decision in the Company's case should be reversed and the case remanded. The decisions in the individual petitioners' cases should be reversed.

June 10, 1960.

Respectfully submitted,

Donald Keith Hall,

Attorney for Petitioners.

APPENDIX.

Petitioners' Exhibit No.	Description	Identified	Offered	Received
1	Declaration of Trust	79	79	79
2	Pleadings, etc. Los Angeles Superior Court action	79	79	79
3	Stipulations, Los Angeles Superior Court action	79	79	79
4	Releases	79	79	79
5	Minutes of December 15, 1950, Board of Directors meeting	79	79	79
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15	1945 Letter from Wackerbarth to Guthrie	128	128	129
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Petitioners' Exhibit No.	Description	Identified	Offered	Received
17	1947 Schalk Note to Union Bank	157	158	158
18	Consent to Cancellation of Dividend	171	171	171
19	1948 Farman Note to Flora Farman	181	182	182
20	1948 Farman Note to Theodore Garbutt	182	183	183
21	1948 Farman Note to Stanley Guthrie	183	183	183
22	1947 Letter from Smith to Guthrie, Darling & Shattuck	184	184	184
23	1950 Assignment Agreement	189	189	189
24	1951 Schalk Check to Union Bank	190	190	190
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27	1951 Schalk Check to Farman	191	191	191
28	Farman Efficiency Record	290	291	291
29	(Withdrawn)			
30	1947 Letter from Dillon to Guthrie	295	295	295
31	Report of Accomplishments, WPA Operations Division, Southern California	297	298	298
32	Minutes of Executive Committee (Schalk)	311	314	314
33	Memorandum of 1945 Sales Meeting (Schalk)	316	317	317
34	Amended Inventory, Estate of Horace O. Smith	318	319	319
35	(Withdrawn)			
36	1948 Baker Note to Dr. Baker	329	329	329
37	1947 Memorandum Concerning Settlement	385	388	388

Respondent's Exhibit No.	Description	Identified	Offered	Received
A	1950 Federal Income Tax Return (Schalk)	79	79	79
B	1951 Federal Income Tax Return (Farman)	79	79	79
C	1951 Federal Income Tax Return (Baker)	79	79	79
D	1942 Audit Report (Schalk)	92	92	92
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I	1951 Government Pay Schedules	210	213	213
J	Schalk Minute Book, Vol. 4	254	255	255
K	Schalk Minute Book, Vol. 5	269	277	277

The parties have stipulated that the foregoing exhibits may be considered in their original form as part of the record herein [R. 466].

CORRECTED

No. 16,702

In the United States Court of Appeals for the Ninth Circuit

SCHALK CHEMICAL COMPANY, a Corporation; GERALD I. FARMAN, HAZEL I. FARMAN, JOHN CARVER BAKER and PATRICIA BAKER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition to Review the Decisions of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court are reported at 32 T.C. 879.

JURISDICTION

This petition for review (R. 70-77) involves federal income taxes. Each notice of deficiency was mailed by the Commissioner of Internal Revenue on

May 23, 1956; in Tax Court Docket No. 63853, a notice of deficiency was mailed to the taxpayer, Schalk Chemical Company, in the amount of $15,-087.22 for the taxable year 1950 (R. 6); in Tax Court Docket No. 63855, a notice of deficiency was mailed to the taxpayers, Gerald I. Farman and Hazel I. Farman in the amount of $11,589.98 for the taxable year 1951 (R. 13-14); in Tax Court Docket No. 63862, a notice of deficiency was mailed to the taxpayers John Carver Baker and Patricia Baker in the amount of $2,465.86 for the taxable year 1951 (R. 22); and in each instance within ninety days thereafter and on August 20, 1956, each taxpayer filed a petition in the Tax Court for redetermination of that deficiency under the provisions of Section 6213 of the Internal Revenue Code of 1954 (R. 6-11, 13-19, 22-27, 43). The decisions of the Tax Court were entered on July 21, 1959. (R. 67-69.) This case is brought to this Court by a petition for review filed on October 19, 1959. (R. 70-77.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

The individual taxpayers and one Smith were the beneficiaries of a trust which owned all of the shares of the taxpayer corporation.[1] In 1948, the taxpayer-

[1] The beneficiaries (Hazel I. Farman and Patricia Baker) are sometimes referred to as the individual taxpayers or as the taxpayer-stockholders; their husbands (Gerald I. Farman and John Carver Baker) are parties to this proceeding because joint returns were filed. One of the trust beneficiaries (Evelyn Smith Marlow) is not a party.

stockholders agreed to purchase Smith's stock interest for $45,000, of which $25,000 was paid by them to Smith upon execution of the agreement, the balance of the purchase price ($20,000) being payable on termination of the trust. In 1950, the corporation voluntarily assumed the obligations of the taxpayer-stockholders under the purchase contract. In 1951, after termination of the trust, the corporation voluntarily reimbursed the taxpayer-stockholders for the $25,000 down payment together with interest from the date of payment, and the corporation also voluntarily paid the $20,000 balance of the purchase price owing by taxpayers to Smith. The corporation deducted the payments in its 1950 return,[2] and the taxpayer-stockholders failed to report the payments as income in any year. Did the Tax Court err in sustaining the Commissioner's determination that the payments made by the corporation (concededly less than its accumulated earnings) on behalf of the taxpayer-stockholders constituted dividend distributions taxable to them and not deductible by the corporation.

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[2] The corporation conceded below that $20,000 of the $45,000, representing the balance of the purchase price owing by the taxpayer-stockholders, is not deductible. (R. 56.)

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

* * * *

(e) *Distributions by Corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. * * *

* * * *

(g) [as amended by the Revenue Act of 1950, c. 994, 64 Stat. 906, Sec. 208(a)] *Redemption of Stock.*—

(1) *In general.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemp-

tion in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

* * * *

(26 U.S.C. 1952 ed., Sec. 115.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.115-1. *Dividends.*—The term "dividend" for the purpose of chapter 1 * * * comprises any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign comporation to its shareholders out of either—

(1) earnings or profits accumulated since February 28, 1913, or

(2) earnings or profits of the taxable year computed without regard to the amount of the earnings or profits (whether of such year or accumulated since February 28, 1913) at the time the distribution was made.

The earnings or profits of the taxable year shall be computed as of the close of such year, without diminution by reason of any distribution made during the taxable year. For the purpose of determining whether a distribution constitutes a dividend, it is unnecessary to ascertain the amount of the earnings and profits accumulated since February 28, 1913, if the earnings and profits of the taxable year are equal to or in

excess of the total amount of the distributions made within such year.

* * * *

A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands.

* * * *

STATEMENT

The facts as found by the Tax Court based in part upon a stipulation between the parties and upon testimony and exhibits introduced at trial may be summarized as follows (R. 42-55):

Schalk Chemical Company, organized in 1903 under the laws of the State of California, manufactures and distributes nationally a line of associated paint products and home repair products. Its books were kept and its returns filed on an accrual basis. (R. 42.)

Horace O. Smith died testate in 1928, being survived by his widow, Hazel I. Smith (now Hazel I. Farman); their three children, Evelyn Smith (now Evelyn Smith Marlow), Horace O. Smith, Jr., and Patricia Smith (now Patricia Baker); and his mother, Charlotte E. Wood. The children were minors at the time, being 15, 14, and 3 years of age, respectively. Hazel I Smith became the wife of Gerald I. Farman on August 14, 1931. (R. 43-44.)

A will contest was filed by decedent's widow which was settled by a Stipulation and Agreement dated

September 26, 1929. Pursuant to the Stipulation and Agreement and Final Decree of Distribution in the Estate of Horace O. Smith, Deceased, Los Angeles Superior Court, No. 100125, a spendthrift trust was created that came into being on December 29, 1930, for a term of 20 years, expiring on December 29, 1950. The principal asset of the trust consisted of all the then-issued and outstanding stock (100,000 shares) of Schalk. The beneficiaries of the trust were Harzel I. Smith (now Hazel I. Farman), Charlotte E. Wood, Evelyn Smith (now Evelyn Smith Marlow), Horace O. Smith, Jr., and Patricia Smith (now Patricia Baker). (R. 44.) After the death of Charlotte E. Wood prior to 1940, the children succeeding to her 12½ percent interest pro rata, and until termination of the trust on December 29, 1950, the beneficial interests were (R. 44-45):

Hazel I. Farman	50 per cent
Evelyn Smith Marlow	16 2/3 per cent
Horace O. Smith, Jr.	16 2/3 per cent
Patricia Baker	16 2/3 per cent

The declaration of the trust appointed three persons to serve successively as "supervisor", each of whom while in office was to have the equivalent of absolute power of management over the trust and the Schalk Chemical Company, including the power and right to appoint a majority (three out of a total of five members) of the board of directors of Schalk and the power and right to vote all the shares of Schalk. The first named supervisor refused to serve. The second, Curtis C. Colyear, served from 1930 until his death in 1943. The third, Horace O. Smith,

Jr., held the office until his resignation in 1948. He was succeeded by Stanley W. Guthrie, who was appointed by court order (R. 45) and who acted as supervisor for the remainder of the term of the trust. Horace O. Smith, Jr., as supervisor of the trust and director and president of Schalk from 1943 to 1948, and through officers and directors which he caused to be elected, dominated and controlled the board of directors of Schalk and in consequence dominated and controlled the management and policies of Schalk. Hazel I. Farman was a "minority director" by virtue of the terms of the declaration of trust. Gerald I. Farman was appointed a "minority director" in 1945 by Evelyn Smith Marlow and Patricia Baker, pursuant to the power to designate a director reserved to them under the declaration of trust. (R. 45-46.)

After Smith became supervisor of the trust and president of Schalk, the other beneficiaries of the trust made a number of suggestions which they thought were in the best interests of the corporation to Smith and the officers and directors of Schalk that Smith had appointed. These suggestions related in part to sales promotion, new products, advertising costs, and automatic equipment. Because of the failure of the corporation to adopt and follow many of these suggestions, controversies arose between Smith and the other trust beneficiaries. Attempts to settle these controversies by setting up an executive committee composed of Smith, Hazel I. Farman, and Gerald I. Farman (Smith's stepfather) to manage the company and by permitting Gerald I. Farman to fill the position of vice president and expediter of raw

materials, were unsuccessful. In April, 1947, Evelyn Smith Marlow and Patricia Baker filed suit to remove Smith, as supervisor of the trust. This suit and the controversy between Smith and the other beneficiaries of the trust were settled, after extended negotiations, by a settlement agreement dated January 15, 1948, resulting in the elimination of Smith's interest in and control over Schalk and the payment to Smith of $25,000 in 1948 and $20,000 in 1951. During the course of the negotiations leading to the settlement agreement, the other beneficiaries of the trust proposed that the settlement be by agreement between Smith and Schalk Chemical Company. Smith rejected their proposals that Schalk be a party to the agreement or pay any part of the money which he was demanding. He insisted upon dealing directly with the other beneficiaries. (R. 46-47.)

Provisions of the above-mentioned settlement agreement of January 15, 1948, by and between Horace O. Smith, Jr., first party, and Hazel I. Farman, Evelyn Smith Marlow, and Patricia Farman Baker, second parties, stated in part the following (R. 47-52):

> For and in consideration of the sum of $25,000 to the First Party in hand by Second Parties, receipt of said sum being hereby acknowledged by First Party, First Party agrees to sell to Second Parties jointly and severally, and Second Parties jointly and severally agree to buy from First Party, subject to the terms and conditions herein contained, upon the termination and distribution of that certain trust dated December 29, 1930 * * * all of the then right, title and

interest of First Party in and to the corpus and any accumulations thereof then belonging or distributed to First Party.

On or before thirty days after the termination of said Trust No. 1071 (which said termination date is hereby agreed as being the 29th day of December 1950), and the actual distribution by the trustee of the corpus and accumulated assets of the trust estate to the beneficiaries then entitled to received the same, Second Parties jointly and severally agree to pay to First Party the sum of $20,000 in then current funds of the United States of America, less the amount of any distribution of any type or character whatsoever, including income, made by said trustee to First Party subsequent to the date hereof and prior to the date of final distribution of the trust estate.

It is understood and agreed that this agreement shall not be intended or construed as an assignment or transfer by First Party of any present right, title or interest of First Party in or to said trust or to the corpus or income thereof, and that no transfer of any interest of First Party in or to said trust, or in or to any corpus or income therefrom, shall be made by First Party until said trust has terminated and the corpus and any accumulated income thereon shall have been distributed to First Party.

It is distinctly understood and agreed that First Party agrees to sell and Second Parties agree to buy all of the assets of said Trust No. 1071 distributed to First Party upon the termination of said trust in whatever form said assets distributable to First Party may then exist, in-

cluding cash, stocks, securities and real and personal property of every kind, nature and description whatsoever. In the event that First Party's beneficial or distributable interest in said trust shall for any reason be increased by reason of the terms and provisions of said trust agreement subsequent to the date hereof and prior to the actual distribution to First Party, such increase shall be included as a part of the property to be transferred by First Party to Second Parties hereunder.

Within five days after actual distribution by the trustee of said trust to First Party of the property herein agreed to be sold to Second Parties, or notice that said beneficial interest of First Party in said trust is ready for distribution to First Party, First Party agrees to deposit into an escrow to be opened with Security First National Bank of Los Angeles or Bank of America National Trust and Savings Association, in the City of Los Angeles, all of the property of every kind, nature and description received by First Party and agreed to be sold hereunder, together with such bills of sale, deeds, conveyances, assignments, or other instruments as may be necessary to vest title thereto in Second Parties, with instructions to deliver all thereof to Second Parties or their assignees upon the payment to First Party of the sum of $20,000.00, less the amount of any distributions made to First Party from said trust subsequent to the date hereof as hereinbefore provided. First Party shall likewise deposit concurrently in said escrow an itemized statement of any such distributions made to him by said trust and shall notify Second Parties of the opening of said escrow.

Second Parties agree within twenty-five days after the receipt of such notice to deposit into such escrow the balance of the purchase price herein provided, and upon receipt of said sum said escrow holder shall be instructed to close said escrow and distribute the remainder of said purchase price to First Party, and the property herein provided to be sold to Second Parties or their assigns, the costs and expenses of said escrow to be paid by Second Parties. Any taxes assessed against the transfer of all property to be sold by First Party hereunder shall be paid by First Party promptly when due.

Said escrow instructions shall provide that if Second Parties or their assigns fall, neglect or refuse to deposit in the aforesaid escrow, within the time and subject to the conditions herein contained, the balance remaining of the aforesaid purchase price, then all property and documents deposited by First Party in said escrow shall immediately be returned to First Party on demand and said escrow shall be terminated.

In consideration of First Party agreeing to resign as supervisor of the trust hereinbefore described and as officer and director of Schalk Chemical Company, a corporation, and of his securing the resignation of Henry O. Wackerbarth as an officer, director and attorney for said corporation, and of H. T. Rausch as a director and auditor of said corporation, the parties hereto agree to enter into a stipulation for the entry of a judgment in the action in the Superior Court of the State of California in and for the County of Los Angeles, entitled Evelyn Smith Marlow and Patricia Farman Baker, as Plaintiffs, vs. Union Bank and Trust Co. of Los

Angeles, a corporation, et al., as Defendants, and numbered 528,107 in said Count, which said stipulation is being entered into concurrently herewith.

In the event that Second Parties, their heirs, successors, or assigns, shall fail, neglect or refuse to pay the balance of the purchase price as herein provided, First Party shall be released from any and all obligation to sell, transfer, convey or assign the property herein described, and Second Parties, their heirs, successors and assigns, shall be released of any and all obligations to purchase said property or to pay to the First Party any additional moneys hereunder.

The entire purchase price for the property herein agreed to be sold by First Party to Second Parties shall be the sum of $45,000.00, less and distributions made by First Party from said trust as herein provided, and the sum of $25,-000.00 paid by Second Parties as consideration to First Party for entering into this agreement shall, in the event Second Parties, their heirs, successors or assigns, comply fully and promptly with the terms and conditions hereof, be applied towards said total purchase price.

This agreement may be assigned by Second Parties, their heirs, successors and assigns, at any time during the term hereof.

First Party agrees, immediately upon request from Second Parties so to do, to apply for and use his best efforts to secure a policy of life insurance insuring the life of First Party, in such form and with such insurance company as Second Parties may request, in the principal sum of $25,000.00 with Second Parties as joint and several beneficiaries thereunder. Second Parties

jointly and severally agree to pay the initial and all subsequent premiums and costs in connection with the securing of said policy, and immediately upon the issuance thereof said policy shall be delivered to and become the property of Second Parties, First Party assuming no liability as to the payment of premiums thereon. Any dividends on said policy shall become the property of Second Parties and no change of beneficiaries shall be made without the consent of Second Parties, First Party hereby agreeing to join in and consent to any change of beneficiaries upon request of Second Parties so to do.

Time is to be and is of the essence of this agreement.

This agreement shall inure to the benefit of the heirs, executors and assigns of the parties hereto.

At a special meeting of the board of directors of Schalk held on January 15, 1948, Horace O. Smith, Jr., presented to the board his resignation as supervisor of the trust and as an officer and director of Schalk and also the resignations of the officers and directors of Schalk whom he had caused to be elected. Resolutions were adopted accepting these resignations. (R. 52.)

On January 15, 1948, Hazel I. Farman, Patricia Baker, and Evelyn Smith Marlow paid Horace O. Smith, Jr., the amount of $25,000. Hazel I. Farman paid $15,000, and Patricia Baker and Evelyn Smith Marlow each paid $5,000. Hazel I. Farman and Patricia Baker borrowed the money to make their portions of the $25,000 payment. The promissory notes given by them for the loans were due and payable on or before January 15, 1951, and bore

interest at the rate of 5 per cent per annum. (R. 52-53.)

The board of directors of Schalk adopted a resolution on December 15, 1950, which authorized the corporation to accept an assignment of the settlement agreement as of December 29, 1950, provided Horace O. Smith, Jr., survived that date; to assume the obligations to Hazel I. Farman, Evelyn Smith Marlow, and Patricia Baker under the settlement agreement; to pay them the amount of $25,000 with interest at 5 per cent from January 15, 1948; and to pay to Smith the amount of $20,000 upon delivery to Schalk of all the property received by Smith as a distributive beneficiary of the trust. As of December 29, 1950, the date of the termination of the trust, Hazel I. Farman, Evelyn Smith Marlow, and Patricia Baker, as "First Parties" and Schalk as "Second Party" entered into an agreement where the first parties assigned to Schalk all of their rights and interests in the settlement agreement of January 15, 1948; Schalk accepted the assignment and assumed and agreed to be bound by all of the obligations of Hazel I. Farman, Evelyn Smith Marlow, and Patricia Baker; and Schalk agreed to pay them the amount of $25,000, plus interest at 5 per cent per annum from January 15, 1948. (R. 53-54.)

In February 1951, Schalk paid $20,000 for the account of Horace O. Smith, Jr., to Union Bank & Trust Company of Los Angeles, $17,364.38 to Hazel I. Farman, and $5,788.13 each to Patricia Baker and Evelyn Smith Marlow. Of such sums the amount of $2,364.38 paid to Hazel I. Farman and the amounts

of $788.13 paid to Patricia Baker and Evelyn Smith Marlow, are claimed by Schalk to represent interest at the rate of 5 per cent per annum from January 15, 1948. (R. 54.)

On February 28, 1951, Horace O. Smith, Jr., and Schalk executed escrow instructions to Union Bank & Trust Company of Los Angeles whereby the corporation deposited $20,000 to be paid to Horace O. Smith, Jr., when pursuant to court order, the bank held for the benefit of Schalk the 16,666 shares which otherwise would have been distributed to Horace O. Smith, Jr. (R. 54.)

On March 20, 1951, an order was entered in the Estate of Horace O. Smith, Deceased, Los Angeles Superior Court, No. 100125, directing that there be distributed to Hazel I. Farman 50,000 shares, to Evelyn Smith Marlow 16,667 shares, to Patricia Baker 16,667 shares, and to Schalk 16,666 shares, of the stock of Schalk. (R. 54-55.)

The net profit or loss (before taxes) of Schalk for the years 1942 through 1951 was as follows (R. 55):

Year	Net Profit or Loss (before taxes)	Year	Net Profit or Loss (before taxes)
1942	$18,170.84	1947	($32,158.67)
1943	63,280.34	1948	26,504.07
1944	77,526.87	1949	5,252.45
1945	46,867.94	1950	47,603.13 *
1946	95,030.80	1951	8,638.91

* Does not include the deductions of $45,000 and $3,697.92 which are at issue.

As of December 31, 1947, the book value of the issued and outstanding stock of Schalk was $1.33 per share. Schalk had done a considerable amount of advertising over a long period of years, and it was the consensus of its board of directors that it had established an extensive good will for its products. No amount for good will was shown on its books. (R. 53.)

Post-1913 accumulated earnings and profits of Schalk as of December 31, 1950, totaled $67,861.31. No formal dividends were declared or paid by Schalk in 1951. (R. 55.)

The Commissioner determined that the taxpayers Gerald I. Farman and Hazel I. Farman received a dividend from the taxpayer Schalk Chemical Company in the taxable year 1951 of $27,000 (3/5 of $45,000), the Farmans' shareholder interest in the corporation then being 60 per cent. The Commissioner determined that the taxpayers John Carver Baker and Patricia Baker received a dividend from the taxpayer Schalk Chemical Company in the taxable year 1951 of $9,000 (1/5 of $45,000), the Bakers' shareholder interest in the corporation then being 20 per cent. The Tax Court held that the Commissioner's determination was correct in each instance and that accordingly the taxpayers, respectively, omitted from their gross income for the taxable year 1951 an amount properly includible therein in excess of 25% of the amount of gross income reported in their returns. (R. 42-43, 55, 61-67.) The Commissioner also disallowed a deduction of $45,000 claimed by the Schalk Chemical Company in 1950 as business

expenses, and a deduction of $3,697.92 claimed by it in that year as interest. The Tax Court sustained the Commissioner's determinations. (R. 42, 60-61.)

SUMMARY OF ARGUMENT

The Tax Court correctly held that the taxpayer corporation's payments to and on behalf of the taxpayer-stockholders represented dividend distributions, not deductible business expenses. The record clearly shows, as the Tax Court found, that the payments were voluntarily made by the corporation to reimburse the taxpayer-stockholders for the $25,000 down payment they had made to purchase Smith's stock interest pursuant to their individual agreement with Smith, and to discharge the taxpayer-stockholders' personal indebtedness to Smith for the $20,000 balance of the purchase price. Taxpayers' argument is erected upon a series of self-serving assumptions which are not supported by the record and were properly rejected by the Tax Court. Their contention that the $25,000 which they paid to Smith (and for which they were later reimbursed by the corporation) was paid on behalf of the corporation in order to "protect" its business, and that the $20,000 payment by the corporation directly to Smith was made in exercise of an option to purchase Smith's interest, runs squarely contra to both the form and the substance of the transaction. As is clear from the very terms of the agreement entered into between the taxpayer-stockholders and Smith, the conduct of the parties, and the other evidentiary facts—all of which

were carefully considered by the Tax Court—the taxpayer-stockholders contracted individually to purchase Smith's stock interest for a total price of $45,000, payable $25,000 down and $20,000 upon termination of the trust in which the shares were held. The corporation's $25,000 payment to the taxpayer-stockholders merely reimbursed them for the down payment portion of the price, while its $20,000 payment to Smith merely discharged their personal indebtedness for the balance of the price.

Under well settled principles, applied by this and other courts, the corporation's payments on behalf and for the personal benefit of the taxpayer-stockholders (totaling less than its accumulated earnings) constituted dividend distributions taxable to them. And since the payments were dividend distributions, there is no basis for the corporation's claim that they are deductible as business expenses. Even assuming *arguendo* that the payments otherwise qualified for deduction by the corporation, they are not deductible in 1950 as claimed, for the payments concededly were made in 1951.

ARGUMENT

The Tax Court Correctly Held That the Payments Made by the Taxpayer Corporation in 1951 for the Personal Benefit of the Taxpayer-Stockholders, in Satisfaction of the Purchase Price Which the Latter Had Individually Obligated Themselves to Pay for Smith's Stock Interest, Were Dividend Distributions Taxable to the Taxpayer-Stockholders in 1951, No Portion of Which Was Deductible by the Corporation in 1950

Horace O. Smith, Jr., his mother, taxpayer Hazel I. Farman, and his two sisters, Evelyn Smith Marlow

and taxpayer Patricia Baker, were beneficiaries of a spendthrift trust which held all of the stock of the taxpayer Schalk Chemical Company. Until the termination date of the trust on December 29, 1950, the shares were to remain in trust and at that time distributions were to be made to the beneficiaries in accordance with their respective interests. Smith held a 1/6 interest in the trust as did each of his two sisters, the balance (½) being held by his mother. The trust provided that Smith was to have control of the board of directors and the management of the corporation. Smith's mother and his stepfather, Gerald I. Farman, also served as corporate directors by virtue of a provision of the trust. (R. 42-46.)

During the period Smith controlled the board of directors and the corporate management, 1943 to 1948, various disputes arose between him and the other trust beneficiaries regarding matters affecting the corporation such as the introduction of new products, sales promotion, improved equipment and advertising costs. After attempts to settle the disputes proved unsuccessful, suit was filed in April, 1947, by Smith's sisters to have Smith removed from control of the corporation. Shortly thereafter Smith and the other beneficiaries entered into negotiations in which Smith offered to sell his beneficial interest in the trust and resign as supervisor of the trust and as an officer and director of the corporation. Smith refused to sell his interest to the corporation but instead demanded that the other trust beneficiaries in their individual capacities purchase his interest. Ac-

cordingly, a contract was entered into between Smith as the selling party and the other three beneficiaries as the purchasing parties. (R. 46-47.)

The contract, dated January 15, 1948, provided for the sale of Smith's beneficial interest to the other beneficiaries for $45,000, of which $25,000 was to be paid on the contract date and the balance, $20,000, within 30 days of the termination of the trust. Accordingly, Smith received $25,000 from the other trust beneficiaries on January 15, 1948, which was paid in proportion to their beneficial interest. Smith then resigned as an officer and director of the corporation as did the other directors whom he had appointed. (R. 47-52.)

At the date of the termination of the trust, December 29, 1950, the purchasing parties, who were then effectively the sole shareholders of the corporation, assigned the agreement of January 15, 1948, to the Schalk Chemical Company, the latter then assuming the $20,000 balance owed Smith. The corporation also agreed to reimburse the then shareholders for the $25,000 they had paid Smith on January 15, 1948, and in addition interest from that date. In February, 1951, the corporation paid Smith the $20,000 owed him by the purchasing stockholders under the contract of January 15, 1948, and reimbursed them for the $25,000 they had paid Smith on the contract date, plus interest thereon. (R. 52-55.)

The Tax Court, after carefully considering all the evidence, held that these payments made by the corporation in 1951 were in substance and effect divi-

dend distributions to the purchasing shareholders (the individual taxpayers), who had personally obligated themselves to purchase Smith's beneficial stock interest in the corporation;[3] and that consequently the payments were taxable to the purchasing stockholders and nondeductible by the corporation. We submit that its decision is clearly correct.

A. *The taxpayer-stockholders having personally contracted to purchase Smith's stock interest, the corporation's payments of the purchase price constituted constructive dividend distributions to them*

The Tax Court's opinion fully explains the reasoning underlying its holding that in the taxable year 1951 the taxpayer-shareholders received dividends proportional to their corporate interest in the total amount paid by the corporation for the shareholders, $45,000, composed of the $25,000 reimbursement payment and the $20,000 payment satisfying their obligation to Smith. (R. 61-666.) The court below noted (R. 62) that under Section 115(a) of the Internal Revenue Code of 1939, *supra*, a dividend might be any distribution to the shareholders by the corporation out of its earnings or profits regardless of whether there is a formal declaration thereof, and irrespective of whether there is a general distribution among all shareholders. *Paramount-Richards Th.* v. *Commissioner*, 153 F. 2d 602 (C.A. 5th); *58th St. Plaza Theatre* v. *Commissioner*, 195 F. 2d 724 (C.A.

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[3] The corporation's accumulated earnings on 1951 were in excess of the $45,000 payments made on behalf of the purchasing stockholders. No formal dividends were declared in that year. (R. 55.)

2d), certiorari denied, 344 U.S. 820; *Sachs* v. *Commissioner*, 277 F. 2d 879 (C.A. 8th). The necessity for examining the true nature of a corporate distribution was recently demonstrated by this Court in *Clark* v. *Commissioner*, 266 F. 2d 698, where it was stated (p. 711):

> To constitute a distribution taxable as a dividend, the benefit received by the shareholder need not be considered as a dividend either by the corporation or its shareholders, declared by the board of directors, nor other formalities of a dividend declaration need be observed, if on all the evidence there is a distribution of available earnings or profits under a claim of right or without any expectation of repayment. * * *

Furthermore this examination requires the utmost scrutiny in cases involving closely held family corporations, such as the situation at bar. *Higgins* v. *Smith*, 308 U.S. 473; *Ingle Coal Corp.* v. *Commissioner*, 174 F. 2d 569 (C.A. 7th); *58th St. Plaza Theatre* v. *Commissioner*, 195 F. 2d 724 (C.A. 2d), certiorari denied, 344 U.S. 820.

The payments in question made by the corporation in the taxable year 1951 arose out of the settlement agreement of January 15, 1948. (R. 46, 60-61.) The Tax Court found that this agreement was between Smith as the selling party and the other beneficiaries as the purchasing party and that the corporation was in no way, formally or informally, a party thereto. (R. 58-59.) The Tax Court also found that the total purchase price to be paid Smith for the sale of his beneficial interest was "$45,000,

$25,000 of which was payable at the time of the execution of the agreement and the remaining $20,000 when the trust terminated". (R. 65.) The taxpayers' argument in this Court is directed toward overturning these findings of the lower court; their position is based upon factual conclusions directly contra to these specific findings of the Tax Court. As has been stated on numerous occasions, the findings of the trial court must be upheld unless it can be shown that they are clearly erroneous. *Helvering* v. *Nat. Grocery Co.*, 304 U.S. 282; *Commissioner* v. *Scottish American Co.*, 323 U.S. 119; *Clark* v. *Commissioner*, *supra*, p. 706. These findings are clearly supported by the evidence introduced below—there are no grounds for urging that they are clearly erroneous.

The settlement agreement of January 15, 1948, names the parties thereto as "Horace O. Smith, Jr., First Party, and Hazel I. Farman, Evelyn Smith Marlow and Patricia Farman Baker, Second Parties". (R. 47.) There is no suggestion whatever in the contract that the corporation was a party or that the taxpayers-beneficiaries were purchasing Smith's interest on behalf of the corporation.

Furthermore, Smith and the attorney representing him testified that he only considered selling his beneficial interest to the other trust beneficiaries. (R. 377-378, 434-435.) In fact, the very reason Smith would not deal with the corporation was stated at trial as being that (R. 434):

> Horace Smith controlled the board of directors, and he couldn't very well sell his interest in a non-assignable trust to the corporation for a sum of money, and ask the vote and approval of the directors that he controlled, because he did control three directors. For that reason, we wouldn't consider any sale to the corporation, of the corporation.

Since Smith held control of the board of directors at that time and would not sell his interest to the corporation, the other beneficiaries could not take it upon themselves either formally or informally to act for the corporation in purchasing Smith's interest.

The Tax Court's findings that "the parties to the settlement agreement were in fact the other beneficiaries and Smith", and that "Schalk was not a party to, and did not authorize the other beneficiaries to enter into, the agreement" (R. 58) are thus amply supported by the evidence. This is clearly a case in which one party having a beneficial interest in the shares of a corporation sold his interest to the other parties who held the balance of the beneficial interest in the corporate shares. See *Niederkrome* v. *Commissioner*, 266 F. 2d 238, 243 (C.A. 9th).

The settlement agreement provided that Smith "in consideration of the sum of $25,000" would sell as of the termination of the trust his "then right, title and interest * * * in and to the corpus and any accumulations thereof then belonging or distributed to" him (R. 47); that "On or before thirty days after the termination" of the trust the purchasing parties (the other beneficiaries) would pay Smith the sum of

$20,000 (R. 47-48); and that "the entire purchase price for the property herein agreed to be sold by the First Party [Smith] to Second Parties [the other beneficiaries] shall be the sum of $45,000 * * *" (R. 51). The Tax Court upon reviewing these contract provisions stated that (R. 61):

> It is apparent from this provision of the agreement that $25,000 was the down payment the other beneficiaries obligated themselves to make (and made) at the time of the execution of the agreement in consideration for Smith's agreement to sell them his minority stock interest at the termination of the trust.

The court below further stated that (R. 65):

> Our conclusion is that the other beneficiaries were obligated under the terms of the settlement agreement to purchase, and Smith to sell, Smith's minority interest in the stock of Schalk; that the purchase price was $45,000, $25,000 of which was payable at the time of the execution of the agreement and the remaining $20,000 when the trust terminated, * * *

The taxpayers throughout their brief claim that this finding of the Tax Court is erroneous. Their brief suggests that the settlement agreement was "skillfully drawn" and "artfully ambiguous" so that Smith could receive favorable tax treatment on the sale. (Br. 24, 26.) They even claim that a document bearing the date of September 12, 1947, sets out the true provisions of the settlement agreement of January 15, 1948 (Br. 26); the latter document, they imply, is not to be given full consideration because

"the form of the settlement was dictated by Smith and the other beneficiaries had no choice" (Br. 22). The taxpayers urge that the settlement agreement of January 15, 1948, be interpreted so that the $25,000 payment made to Smith by the other beneficiaries on the date of the agreement should be viewed as a payment for the resignation of his position, which gave him control of the corporate board of directors and management of the corporation. The balance, $20,000, taxpayers claim, should be viewed as a payment for Smith's corporate shares. (Br. 24-26.)

The taxpayers' evidence consisted of their own self-serving testimony and a document ante-dating the settlement agreement of January 15, 1948. The Tax Court's finding regarding this matter is fully supported by the testimony of Smith and the attorney who represented him in the settlement agreement of January 15, 1948. (R. 378-380, 416-417, 421-422, 447, 451.) The testimony of the party who sold his interest (Smith), together with the corroborating testimony of his attorney, fully warrant the finding of the Tax Court that Smith sold his 1/6 beneficial interest in the trust for $45,000, $25,000 of which was to be paid at the contract date and the balance of $20,000 was to be paid within 30 days subsequent to the termination of the trust. Indeed, the Tax Court's finding is demanded by the very terms of the settlement agreement itself. That agreement provides (R. 51):

> The entire purchase price for the property herein agreed to be sold by First Party to Second Parties shall be the sum of $45,000.00, less any

> distributions made by First Party from said trust as herein provided, and the sum of $25,000.00 paid by Second Parties as consideration to First Party for entering into this agreement shall, in the event Second Parties, their heirs, successors or assigns, comply fully and promptly with the terms and conditions hereof, be applied towards said total purchase price.

The taxpayers seek to overturn the Tax Court's finding on testimony that is merely self-serving and in fact in direct conflict with that presented by the party who sold his interest to the taxpayers-shareholders. Further, the taxpayers urge an interpretation of the settlement agreement that is directly refuted by express provisions of the settlement agreement. When faced with a similar contention of a taxpayer who was attempting to establish that a corporate distribution was not a dividend, the Third Circuit said (*Ferro* v. *Commissioner*, 242 F. 2d 838, 843):

> We refuse to engage in a metaphysical discussion of semantics in an endeavor to adopt a factual inference proposed by a litigant, when the judicial eye should be "case directly and primarily upon the evidence in support of those [inferences] made by the Tax Court". *Commissioner of Internal Revenue* v. *Scottish-American Investment Co.*, 1944, 323 U.S. 119, 124, 65 S. Ct. 169, 171, 89 L. Ed. 113.

See also *Woodworth* v. *Commissioner*, 218 F. 2d 719, 722-723 (C.A. 6th).

As the Tax Court held, Smith sold his beneficial interest in the trust which held the shares of Schalk

to the other trust beneficiaries for $45,000. As the Tax Court further noted (R. 58-59), the taxpayers-shareholders, and not the corporation, received the benefit of the corporation's payments of the purchase price. The taxpayers-shareholders by purchasing Smith's interest were able to participate in the corporate management and control approximately three years prior to the termination of the trust. See *Niederkrome* v. *Commissioner*, *supra*, p. 243. When the trust terminated and the trust beneficiaries became the sole shareholders of the corporation, Schalk Chemical Company satisfied the balance of the amount owed Smith by the shareholders in addition to reimbursing them for payments they had made to Smith on the underlying obligation. Clearly both the corporate payments which reimbursed the shareholders for payments they had made to Smith, $25,000, and the satisfaction of the amount still owed Smith by the shareholders, $20,000, were dividend distributions to the shareholders. *Wall* v. *Commissioner*, 164 F. 2d 462 (C.A. 4th); *Zipp* v. *Commissioner*, 259 F. 2d 119 (C.A. 6th); *Paramount-Richards Th.* v. *Commissioner*, *supra*.

1. *The $25,000 payment*

The corporation was not a party to the contract of January 15, 1948, between Smith and the other trust beneficiaries. The taxpayers concede this fact on brief. (Br. 20.) Nonetheless when the trust terminated on December 29, 1950, and the beneficiaries who purchased Smith's interest on January 15, 1948, effectively became the sole shareholders of the cor-

poration (R. 62), the purchasing stockholders purported to obligate the corporation to reimburse them for the $25,000 they had paid Smith at the date of the purchase agreement, plus interest from that date (R. 53-54). As pointed out by that Court (R. 59-60), the corporation was under no legal obligation to reimburse the shareholders for their payment. The corporation never authorized the purchase of Smith's interest, either formally or informally. The taxpayers apparently urge, as they did below, that the corporation was obligated on moral grounds to reimburse the shareholders (Br. 18-20), a contention which the Tax Court properly rejected as without merit (R. 58-59).

The $25,000 reimbursement payment made by the corporation in 1951 to the shareholders was properly characterized by the Tax Court as entirely voluntary. (R. 61.) It was a corporate distribution voluntarily paid to its shareholders to reimburse them for their own personal obligation for a benefit they had received. Such a distribution is a dividend to the shareholders. *American Properties, Inc.* v. *Commissioner*, 262 F. 2d 151 (C.A. 9th); *Greenspon* v. *Commissioner*, 229 F. 2d 947 (C.A. 8th); *58th St. Plaza Theatre* v. *Commissioner, supra; Zipp* v. *Commissioner, supra.*

2. *The $20,000 payment*

At the time the trust terminated the corporation also purported to obligate itself to satisfy the $20,000 balance of the debt owed Smith by the shareholders. The Tax Court properly upheld the Commissioner's determination that the $20,000 payment made by the corporation to Smith "constituted a distribution es-

sentially equivalent to a dividend" to the taxpayer-stockholders. (R. 63.) Payments made by a corporation to satisfy an obligation of the corporate shareholders to third parties are dividend distributions to the shareholders. This proposition has perhaps been best stated in *Wall* v. *Commissioner*, *supra*, p. 464:

> The controlling fact in this situation was that Wall was under an obligation to pay Coleman $5,000 in the tax year and that Rosedale paid this indebtedness for Wall out of its surplus. It cannot be questioned that the payment of a taxpayer's indebtedness by a third party pursuant to an agreement between them is income to the taxpayer. *Douglas* v. *Willcuts*, 296 U.S. 1, 9, 56 S. Ct. 59, 80 L. Ed. 3, 101 A.L.R. 391; *United States* v. *Boston & Maine R. Co.*, 279 U.S. 732, 49 S. Ct. 505, 73 L. Ed. 929; *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716, 49 S. Ct. 499, 73 L. Ed. 918. The transaction is regarded as the same as if the money had been paid to the taxpayer and transmitted by him to the creditor; and so if a corporation, instead of paying a dividend to a stockholder, pays a debt for him out of its surplus, it is the same for tax purposes as if the corporation pays a dividend to a stockholder, and the stockholder then utilizes it to pay his debt.

Here the corporate funds used to satisfy the taxpayer's obligation for the purchase of Smith's interest benefited the shareholders, as held by the Tax Court, and not the corporation, as claimed by the taxpayers (R. 58-59); consequently, there can be no question but that the true nature of these payments

was a dividend to the taxpayers-shareholders so benefited. *Ferro* v. *Commissioner*, *supra*; *Zipp* v. *Commissioner*, *supra*. As the Tax Court stated (R. 66):

> When the transaction was concluded therefore the other beneficiaries were in substantially the same position they would have been in if Schalk had not assumed their obligation and had distributed to them $20,000 and they had used this money to satisfy their obligation to purchase the portion of Schalk's outstanding stock, owned by Smith, which they did not then own.

This Court has repeatedly held that the net effect of the transaction being reviewed is of the upmost importance in determining whether a corporation distribution is a dividend to the shareholders. *Pacific Vegetable Oil Corp.* v. *Commissioner*, 251 F. 2d 682; *Earle* v. *Woodlaw*, 245 F. 2d 119, certiorari denied, 354 U.S. 492; *Hirsch* v. *Commissioner*, 124 F. 2d 24. There is no question here that the net effect and substance of the transaction, whereby the corporation satisfied the shareholders' obligation, were the same as if a dividend was first issued and the shareholders personally satisfied their debt from it. Furthermore, it should be noted that the same individuals who purchased Smith's interest in their own name were able to satisfy the balance of their obligation to Smith and reimburse themselves for payments made to Smith by use of corporate funds by virtue of their complete control of the corporation. The facts show that there were sufficient earnings and profits for the corporation to have declared a dividend of $45,000 to its shareholders (R. 55), and the record contains

no suggestion whatsoever that the $20,000 paid to Smith resulted in a contraction of the corporate business because of this distribution of the corporate funds. *Ferro* v. *Commissioner*, *supra*, p. 841.

The taxpayers would have the settlement agreement of January 15, 1948, interpreted so that the $20,000 payable on the date of the termination of the trust was only an option price for the purchase of Smith's interest in the corporate shares. (Br. 33.) The argument is ostensibly an effort by taxpayers to assimilate this case to the entirely different set of facts presented in *Holsey* v. *Commissioner*, 258 F. 2d 865 (C.A. 3d), where an option held by the shareholders was assigned to the corporation. This case is plainly distinguishable. See *Zipp* v. *Commissioner*, *supra;* Rev. Rul. 58-614, 1958-2 Cum. Bull. 920. The language of the settlement agreement, upon which taxpayers rely did not convert a binding contract for the purchase of Smith's interest for $45,000 into a mere option to purchase for $20,000. In the words of the Tax Court (R. 64-65):

> This isolated provision of the settlement agreement merely restricts the remedy of Smith, in the event the other beneficiaries default and fail to pay the $20,000 balance of the purchase price, to the retention of the $25,000 down payment. Somewhat similar provisions in other contracts have been held not to give the purchaser a mere option to purchase where other provisions thereof clearly indicate that it was the intention of the parties to enter into a binding contract for the purchase and sale of property. See *Vance* v. *Roberts*, 93 Fla. 379, 118 So. 205; *Wright* v.

Suydam, 72 Wash. 587, 131 P. 239; and cf. *Rodriguez* v. *Barnett*, 333 P. 2d 402 (Cal. App. 1958). Here the settlement agreement provides that, "It is distinctly understood and agreed that First Party [Smith] agrees to sell and Second Parties [the other beneficiaries] agree to buy all of the assets of said Trust * * * distributed to First Party upon the termination of said trust * * *" and that the "First Party agrees to sell * * * and Second Parties jointly and severally agree to buy * * * all of the then right, title and interest of First Party in and to the corpus and accumulations * * * of the trust."

B. *The payments were not deductible by the corporation as business expenses*

The corporation claims that the $25,000 portion of the purchase price of Smith's interest, for which it reimbursed the taxpayers-shareholders in 1951, together with interest thereon, but which it accrued on its books in 1950, is deductible by it in 1950 as an ordinary and necessary business expense under Section 23(a)(1)(A) of the Internal Revenue Code of 1939.[4] Initially, the corporation claimed that the

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[4] SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

entire $45,000 purchase price paid on behalf of the stockholders was deductible as an expense; however, as noted by the Tax Court (R. 58), the corporation subsequently conceded that $20,000 was not an expense of its operations. The corporation's theory is that the $25,000 was paid by the taxpayers-stockholders to Smith in consideration of Smith's resignation from the board of directors, in order to "protect or promote" the corporation's business, and that the corporation was obligated to reimburse them. (Br. 10-20.) The corporation's argument here is premised on the same invalid assumptions which underly the taxpayers-stockholders' contention with respect to the taxability of the $45,000 payments in question as dividends.

Since both the $25,000 and the $20,000 payments in question were dividends to the shareholders, as we have already shown, the taxpayer-corporation is not entitled to a deduction of any portion thereof (or any interest paid thereon) as an ordinary and necessary business expense. Furthermore, even assuming *arguendo*—contrary to the terms of the purchase agreement and the Tax Court's findings—that the corporation rather than the taxpayer-stockholders purchased Smith's stock interest, the payments in question nevertheless would not qualify for deduction as a business expense of the corporation; they would then have represented nondeductible capital distributions by the corporation in redemption of Smith's shares. Moreover, even further assuming *arguendo* that the $25,000 reimbursement payment by the corporation to the taxpayer-stockholders was paid in considera-

tion for Smith's giving up his control and management of the corporation, the corporation's claim still must fail, for it has failed to meet its burden of proving that the expenditure was an ordinary and necessary business expense. *American Properties, Inc.* v. *Commissioner, supra; Greenspon* v. *Commissioner, supra; Byers* v. *Commissioner*, 199 F. 2d 273, 275 (C.A. 8th). In fact the Tax Court found to the contrary, for it explicitly stated regarding Smith's ability to manage and control the corporation that (R. 59)—

> * * * we are not convinced that the management of the corporation under Smith was incompetent and that their action was either necessary or desirable to preserve its business.

The taxpayer-corporation has failed to demonstrate ~~any error in~~ the above statement of the Tax Court is in error.[5]

In any event, the payment having been made in 1951, there is no basis for its claimed deduction in 1950 merely because the corporation in that year voluntarily and gratuitously promised to make the payment.

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[5] The Tax Court also noted (R. 61), that the interest paid to the taxpayers-shareholders, which the corporation also claims as deduction (Br. 8), fails to qualify as an interest expense, there being no indebtedness of the corporation.

CONCLUSION

For the reasons presented herein, the decisions of the Tax Court should be affirmed in all respects.

Respectfully submitted,

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No. 16702

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SCHALK CHEMICAL COMPANY, a corporation, GERALD I. FARMAN, HAZEL I. FARMAN, JOHN CARVER BAKER and PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of Decisions of the Tax Court of the United States.

PETITIONERS' REPLY BRIEF.

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PETITIONERS' REPLY BRIEF.

Introduction.

Respondent's brief reiterates the Tax Court's reasoning and in like vein submits arguments predicated directly or obliquely on one primary proposition, that determination of this case is governed by the form, not the substance, of the transactions which allegedly give rise to the assessments in question.

Respondent (like the Tax Court) does not come to grips with this case.

I.

Viewed in the Light of Applicable Law Relating to Spendthrift Trusts, the Terms of the Settlement Agreement Demonstrate That the $25,000 Was Paid for Smith's Surrender of Control of the Company.

Neither the Tax Court nor respondent discusses or attaches any significance to the fact that the trust, which until December 29, 1950, owned all the shares of the Company, was a spendthrift trust.[1]

The spendthrift provisions of the trust [Ex. 1, Art. II, Paragraph (O), pp. 14-15] are quoted at pages 26 to 27 of petitioners' opening brief. Any alienation of the beneficial interests was prohibited.

As discussed at pages 27 to 29 of petitioners' opening brief, the trust was created in California which recognizes and enforces spendthrift trusts.

Under California law, the 1948 settlement agreement [Ex. 16] wherein Smith purported to contract to sell his beneficial interest to the other beneficiaries was abortive as such. An assignment of or contract to assign a beneficial interest in a spendthrift trust passes no interest of any kind in or to the trust property and is not specifically enforceable even after termination of the trust.

As stated in *Kelly v. Kelly,* 11 Cal. 2d 356, 79 P. 2d 1059, 119 A. L. R. 71 (1938):

> ". . . A voluntary assignment executed before payment to the beneficiary [of a spendthrift trust]

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[1]The Tax Court mentions the fact once [R. 44], respondent twice (Br. pp. 7, 20).

confers on the assignee *no right to demand payment or delivery from the trustee as it becomes due to the beneficiary* . . .

* * * * * * * * * * * * *

". . . [A]n assignment by the beneficiary, in the nature of a promise to pay or turn over trust property when received by him, . . . gives the promisee *no right in specific trust property received by the beneficiary, or in its proceeds,* . . ." (11 Cal. 2d at pp. 362-363.)[2]

And, in Scott on *Trusts* (2d ed.), Vol. II, §152.6, at page 1067:

"Where the interest of a beneficiary of a trust is by the terms of the trust or by statute not transferable by him, and he makes a contract to assign it, *the contract is not specifically enforceable* even though consideration was received by the beneficiary."

Also see California Civil Code, Section 3386.

Such an assignment or contract to assign is wholly invalid under California law, except as it may give the promisee the dubious right to sue to recover damages personally from the beneficiary if he fails to perform. (*Kelly v. Kelly, supra.*) But suppose Smith had died prior to termination of the trust. The agreement, being invalid, was not binding on his heirs. No one would have been answerable even for damages.

It must be assumed that the settlement agreement with Smith was written with full awareness of its legal

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[2]Emphasis in quoted material added throughout unless otherwise noted.

ineffectiveness as a contract for the purchase and sale of Smith's beneficial interest. (The other beneficiaries, it should be noted, were represented by well known and very able counsel, Stanley W. Guthrie.) Certainly the other beneficiaries did not borrow the $25,000 and pay it to Smith for nothing. What then was the purpose of the agreement?

Petitioners contend that the purpose of the settlement agreement was to secure Smith's resignation as Supervisor of the trust and consequent relinquishment of control of the Company and that it was for this that the $25,000 was agreed to be (and was) paid. Incidentally as far as the other beneficiaries were concerned, but of importance to Smith from a tax standpoint, the other beneficiaries were given the right, if they desired, to purchase Smith's share of the trust property for $20,000, provided he survived termination of the trust and chose to honor the agreement [*cf.* Ex. 22].

The terms of the settlement agreement confirm this. The first paragraph states that, in consideration of $25,000 "in hand" paid to Smith by the other beneficiaries and for which receipt was acknowledged, Smith agreed to sell to the other beneficiaries and the other beneficiaries agreed to buy his beneficial interest in the trust upon its termination and distribution [Ex. 16, p. 1; R. 47]. The second through the seventh paragraphs provide that within 30 days after termination and actual distribution of the trust the other beneficiaries would pay $20,000 to Smith [Ex. 16, p. 2;

R. 47-48] by deposit in escrow [Ex. 16, p. 3; R. 49] pursuant to escrow instructions providing that if the other beneficiaries failed to deposit "the aforesaid purchase price" Smith could terminate the escrow [Ex. 16, p. 4; R. 50].

Smith agreed to resign immediately as Supervisor of the trust and as an officer and director of the Company and to secure the resignation of the officers and directors he had appointed and the parties agreed to enter into concurrently a stipulation for entry of judgment in the 1947 Superior Court action to remove Smith as Supervisor [Ex. 16, pp. 4-5; R. 50-51].

It is not until the fifth page of the agreement that the sum of $45,000 is stated to be the purchase price of Smith's beneficial interest [Ex. 16, p. 5; R. 51]. The particular provision was put into the agreement at the insistence of Smith's attorney [R. 447-448].

Taken as a whole, what does the 1948 agreement add up to? Eliminating all of the nugatory provisions purporting to commit Smith to sell and the other beneficiaries to buy his beneficial interest on termination of the trust, the objective of the agreement becomes clear. Its purpose was to secure the immediate resignation of Smith as Supervisor of the trust and as President and director of the Company and the resignation of the officers and directors appointed and controlled by him. Smith's relinquishment of control took place immediately upon execution of the agreement [R. 34-35]. It was to accomplish this, and only this, that the $25,000 was paid.

II.

The $25,000 Was Paid for the Protection and Preservation of the Company.

At pages 4 to 5 and 13 to 16 of their opening brief, petitioners outlined the testimony and evidence supporting their contention that on January 15, 1948, the date of the 1948 settlement agreement, and prior thereto, reasonable grounds existed for the belief that Smith's management and policies were endangering the Company and that the Company might suffer irreparable damage and possible failure prior to termination of the trust on December 29, 1950. (Smith's extraordinary trust powers and right to control the Company, of course, would have ended automatically when the trust terminated. He was only a one-sixth beneficial owner.) Petitioners also pointed out that the testimony and evidence so outlined were not contradicted by Smith in any essential respect (Br. p. 16). Respondent does not dispute this.

Assuming *arguendo* that the Company paid the $25,000 to Smith in consideration of his giving up control and management of the Company, respondent asserts (Br. p. 36) that the Company has failed to meet its burden of proving that the expenditure was an ordinary and necessary business expense and in support thereof is content to rely entirely on this statement from the Tax Court's opinion:

> ". . . we are not convinced that the management of the corporation under Smith was incompetent and that their action was either necessary or desirable to preserve its business" [R. 59].

This asserted finding, however, misses the mark completely. It was not the Company's burden to prove *to*

the Tax Court's satisfaction that Smith's management was "incompetent" or that his removal was necessary to preserve the Company's business. This would place an impossible burden on the Company. As shown at pages 17 to 18 of petitioners' opening brief, the question which the Tax Court should have passed on, but did not,[3] is whether at the time of the settlement there existed reasonable grounds for the belief that Smith's management and policies were jeopardizing the future of the Company. If such belief was well grounded—*as it was*—an expenditure made to cause Smith to relinquish control qualifies as an ordinary and necessary business expense for the protection and preservation of the Company. See the cases cited by petitioners at pages 11 to 13 and 17 to 18 of their opening brief, and particularly *Levitt & Sons v. Nunan,* 142 F. 2d 795 (2 Cir. 1944), and *Boulevard Frocks, Inc.,* T. C. Memo. Dec. (1943). In *Boulevard Frocks,* for example, amounts paid by a company to buy up the employment contracts of certain of its stockholders who were disrupting its business were held to be ordinary and necessary business expenses, to preserve, promote and protect the company's business.

Respondent chooses not to discuss any of the cases cited by petitioners in this regard, presumably because of reliance on the *form* of the transaction between Smith and the other beneficiaries. And, it was on the basis of *form* that the Tax Court dismissed the cases cited at pages 18 to 19 of petitioners' opening brief concerning the Company's obligation to reimburse

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[3]Compare, "We are satisfied that they thought their participation would be beneficial to the corporation." [R. 59.]

the other beneficiaries for the $25,000 paid to Smith, to preserve and protect the Company.

An additional case should be noted, *Waring Products Corporation,* 27 T. C. 921 (1957), in which it was stated:

> "We know of no requirement that there must be an *underlying legal obligation* to make an expenditure before it can qualify as an 'ordinary and necessary' business expense . . ." (27 T. C. at p. 929.)

The entire scope of the Tax Court's decision and respondent's position on deductibility of the $25,000 is epitomized in these statements from the opinion below:

> "This reasoning overlooks the fact that *the trust agreement,* which created their beneficial interests, *placed complete control of Schalk in Smith,* the supervisor of the trust, *and prevented them from acting for or on its behalf. Not having any power to act for Schalk,* we fail to see how any action taken by them can be deemed to be the action of Schalk." [R. 58.]

But this approach dramatically places form over substance. It overlooks the conflict of interest between Smith, as supervisor of the trust, and Smith, as an individual beneficial owner. For reasons that had nothing to do with the welfare of the Company [R. 434; quoted by respondent, Br., p. 25], Smith refused to let the Company be a party to or authorize the settlement, although he was cognizant that something had to be done for the Company's protection [Ex. 22].

As stated in *Fox v. Harrison,* 145 F. 2d 521 (7 Cir. 1944), at p. 522:

> ". . . [The Government's] theory is apparently predicated upon the mere form of the transaction, without giving consideration to the substance. In reality, the involved stock was purchased by the corporation . . ."

The *Fox* case is discussed in full at pages 31 to 32 of petitioners' opening brief. The "involved stock" was purchased by Fox, a minority shareholder. The corporation had been unable to buy the stock. It did not authorize Fox to buy the stock. Fox bought it, however, for the Company's protection. The Court treated the transaction as in reality a purchase of the stock by the corporation.

Likewise here, the Company was not able to act for its own protection. The majority owners acted for it. The $25,000 payment to Smith, in reality, was a payment made directly by the Company and deductible by it.[4]

---

[4]Respondent suggests that in any event the expenditures were not deductible in 1950 because the payments were made in 1951 (Br. pp. 19, 36). If disallowance were on that ground, the determination should so declare so that the Company can claim relief under Section 1311 of the Internal Revenue Code of 1954. None of the years involved, commencing with 1948, is barred from adjustment under Section 1311. The Company, however, is on an accrual basis and for that reason accrued the $25,000 liability in 1950, the year in which it promised to make the payment [Ex. 23].

III.

Neither the Reimbursement of the $25,000 nor the Payment of the $20,000 Constituted a Taxable Dividend to the Other Shareholders.

As discussed in Point I the other beneficiaries acquired no capital asset or right to a capital asset by reason of the $25,000 payment to Smith. The payment, however, did serve to rid the Company of Smith's domination. As discussed in Point II it was paid for that purpose, to protect the Company.

The other beneficiaries had to borrow the $25,000 which was paid to Smith [R. 186; Exs. 19, 20, 21, 36]. They realized no economic gain from the Company's reimbursement of the $25,000. And, they derived no more benefits from the change in management than they would have derived had the Company paid the $25,000 directly to Smith, in which event the individual petitioners could not have been charged with any omitted dividend income [*cf.* R. 58-59].

As observed by this Court in *Niederkrome v. Commissioner of Internal Revenue,* 266 F. 2d 238 (9 Cir. 1959), at p. 243:

> "It can be argued that taxpayers got full control of the corporation. But should this circumstance, standing alone, be considered an economic or financial advantage?"

The other beneficiaries paid Smith for the protection of the Company. As discussed in Point II, the transaction should be treated in substance as a pay-

ment of the $25,000 by the Company directly to Smith. Since the money was borrowed and paid by the other beneficiaries *for the Company* its reimbursement is not a dividend. This proposition is supported by *Fox v. Harrison,* 145 F. 2d 521 (7 Cir. 1944), discussed and quoted at pages 31 to 32 of petitioners' opening brief. Respondent does not discuss the *Fox* case.

Moreover, for the reasons stated in Point I, the settlement agreement between Smith and the other beneficiaries was ineffective as a contract for the purchase and sale of Smith's beneficial interest because of the spendthrift provisions of the trust. The other beneficiaries *were not obligated* to pay $20,000 to Smith in 1951. The agreement could not have been enforced against them. The Company's payment of $20,000 to Smith in 1951 for the shares of the Company's stock distributed to him, therefore, did not satisfy any obligation of the other shareholders and did not result in a distribution essentially equivalent to a dividend to the other shareholders. This proposition is supported by *Holsey v. Commissioner of Internal Revenue,* 258 F. 2d 865 (3 Cir. 1958), and Rev. Rul. 58-614, 1958-2CB 920, discussed and quoted at pages 33 to 34 of petitioners' opening brief.

In all events, assuming (without conceding in any respect) that the settlement agreement, as contended by respondent, was a valid and enforceable contract for the purchase of Smith's stock interest on termination of the trust (despite the spendthrift provisions of the trust) and that the $25,000 represented truly a down payment on the purchase price (which, as discussed above, is not the case), petitioners submit that *John A. Decker,* 32 T. C. 331 (1959), discussed and quoted

at pages 34 to 37 of petitioners' opening brief, is indistinguishable from this case and requires reversal of this case insofar as the individual petitioners are concerned. Respondent does not discuss the *Decker* case, and it is not cited in the opinion below.

The taxpayer-stockholders in *Decker* were obligated by written agreement to purchase the stock of a deceased stockholder. They purchased the stock and immediately transferred it to the corporation for the same price. The Tax Court held that there was no true economic benefit to the survivors justifying treating the redemption as a constructive dividend to them, stating:

> *"Petitioners did not receive any true economic benefit from the transactions when considered as a whole.* They had the same amount of cash and the same number of shares of stock after the transactions were completed as they had before the death of the deceased stockholder. Their stock represented a higher percentage of equity in the basic assets of the company, but those assets were reduced proportionately so the stock actually represented the same value, assuming that the book value for which the stock was bought and sold represented the value of the underlying assets. So petitioners gained nothing from the distribution unless it is that the use of company funds to meet their obligations under the stock purchase agreement produced an economic benefit for them.
>
> * * * * * * * *
>
> *". . . The corporation did not pay a pre-existing debt of the petitioners, the satisfaction of which would increase their net worths. They realized no economic benefit from the transaction."*

The net worths of the other shareholders in this case were not increased; in fact they were decreased. Smith's stock interest was not worth $45,000.[5] (On the question of whether payment of an excessive price results in a dividend to the remaining stockholders, see *Fred F. Fischer,* T. C. Memo. Dec. (1947), discussed and quoted at pages 37 to 38 of petitioners' opening brief.) The other shareholders had the same number of shares after the transactions were completed as they had before. The fact that the purchase price, under respondent's theory, was payable $25,000 "down" and $20,000 on termination of the trust is a distinction without a difference.

Rev. Rul. 59-286, 1959-36 IRB 9, discussed and quoted at pages 36 to 37 of petitioners' opening brief, also is inherently inconsistent with the Tax Court's decision in this case. Rev. Rul. 59-286 holds that where a surviving stockholder had entered into an agreement that, upon the death of the other stockholder, he would either purchase the decedent's stock or vote his stock for dissolution of the corporation, and instead the corporation redeemed the stock, no dividend results to the surviving stockholder. The Ruling contains this significant statement:

> ". . . *there is no authority affirmatively supporting* the proposition that a redemption of one stockholder's shares, at fair market value, constitutes a dividend to a remaining shareholder . . ." (1959-36 IRB at p. 10.)

---

[5]The book value of the Company's stock on December 31, 1947, was $1.33 per share [R. 35].

Conclusion.

The decision in the Company's case should be reversed and the case remanded. The decisions in the individual petitioners' cases should be reversed.

September 30, 1960.

Respectfully submitted,

DONALD KEITH HALL,

Attorney for Petitioners.

No. 16702.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SCHALK CHEMICAL COMPANY, a corporation, GERALD I. FARMAN, HAZEL I. FARMAN, JOHN CARVER BAKER and PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of Decisions of the Tax Court of the United States.

PETITION FOR REHEARING.

DONALD KEITH HALL,
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Attorney for Petitioners.

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TABLE OF AUTHORITIES CITED

No. 16702.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SCHALK CHEMICAL COMPANY, a corporation, GERALD I. FARMAN, HAZEL I. FARMAN, JOHN CARVER BAKER and PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Review of Decisions of the Tax Court of the United States.

PETITION FOR REHEARING.

To the Honorable Albert Lee Stephens, Stanley N. Barnes and M. Oliver Koelsch, United States Circuit Judges, before whom this case was heard:

Petitioners respectfully petition for a rehearing in this case on the following grounds:

I.

The Court holds that if Farman, Baker and Marlow had breached the settlement agreement they would have been liable in damages to Smith and, since this possible liability was discharged by the $20,000 payment which Schalk made to Smith, the payment constituted a constructive dividend proportionately to Farman and Baker (Op. pp. 8-9).[1] The Court apparently agrees that if no obligation existed which Schalk discharged by the

[1]The references are to the printed slip opinion.

$20,000 payment to Smith, no constructive dividend resulted. *Holsey v. Commissioner of Internal Revenue,* 258 F. 2d 865 (3 Cir. 1958), is distinguished on this ground (Op. p. 5 f.6).

The Court does not mention and presumably gave no consideration to the following provision of the settlement agreement:

> "In the event that Second Parties, their heirs, successors, or assigns, shall fail, neglect or refuse to pay the balance [$20,000] of the purchase price as herein provided, First Party [Smith] shall be released from any and all obligation to sell, transfer, convey or assign the property herein described, and Second Parties [Farman, Baker and Marlow], their heirs, successors and assigns, *shall be released of any and all obligations to purchase said property or to pay to First Party any additional moneys hereunder.*" [Ex. 16, p. 5. Emphasis added].

Schalk's $20,000 payment to Smith satisfied no possible liability of the other shareholders to Smith, and, as in *Holsey,* the payment resulted in no constructive dividend as to them.

The mutual release provision also supports petitioners' argued position that the $25,000 payment was for Smith's resignation as supervisor of the trust and the $20,000 payment was for his stock interest. If the latter payment were not made and the mutual release became operative, Smith was to retain the $25,000 payment *and* his stock. If the $25,000 was part payment on the stock, he could not retain both without being unjustly enriched to the extent of the value of the stock. *Cf., e.g., Freedman v. The Rector,* 37 Cal. 2d 16 (1951). The illegality is avoided if the $25,000 is treated, as it should be, as payment for his resignation, not his stock.

In this regard, petitioners do not contend that the settlement agreement is "divisible" into two separate

contracts (*cf.* Op. pp. 3-4, 6-7). They do contend that the $25,000 was for Smith's resignation as supervisor of the trust and the $20,000 was for his stock interest.

The mutual release provision has an important bearing on the issues respecting the $20,000 payment (constructive dividend) and respecting the $25,000 payment (deductibility and dividend equivalence). The failure to consider the provision is a material defect.

II.

The Court seems to view as correlative the disallowance of the $25,000 deduction in Schalk's case and the determination of dividend equivalence in the individuals' cases. The same Tax Court "findings" are relied on (Op. pp. 6-8), although the statutory criterion for each issue is different, "ordinary and necessary . . . in carrying on any trade or business" as compared with "essentially equivalent to the distribution of a taxable dividend."

The Tax Court recognized the distinction. Its "finding" which the Court quotes (Op. p. 7), to the effect that the Tax Court was not "convinced" that a change in management "was either necessary or desirable to preserve its [Schalk's] business," went to deductibility of the $25,000, not its dividend equivalence. The finding played no part in the Tax Court's determination of the latter issue.[2]

The Court's treatment of the two issues as interrelated is a material defect.

---

[2]The pivotal issue as to dividend equivalence of the $25,000 is: Did the individual petitioners derive any taxable economic benefit as a result of the $25,000 payment to Smith? *Niederkrome v. Commissioner of Internal Revenue,* 266 F. 2d 238 (9 Cir. 1958); *John A. Decker,* 32 T. C. 326 (1959), affirmed per curiam, 286 F. 2d 427 (6 Cir. 1960).

III.

The opinion's premise is that Schalk derived no benefit from the payments in question, but instead that the individual petitioners personally profited and benefited, and therefore the deduction claimed by Schalk was properly denied and the reimbursement was a dividend (Op. pp. 7-8).

The only "benefit" which it is suggested the individual petitioners gained was the right to participate in management and control of the company (Op. p. 7), a right which the Tax Court found they believed would prove beneficial to the company [R. 59]. The Tax Court was not of the view that the individual petitioners acted solely, or even "primarily", to secure a personal profit or benefit independent of the benefits which they believed would flow to the company. Nor did the Tax Court make any finding that the anticipated benefits to the company did not in fact materialize.

If the mere fact that the individual petitioners secured control makes the reimbursement a dividend, then this Court was wrong in remanding *Niederkrome v. Commissioner of Internal Revenue,* 266 F. 2d 238 (9 Cir. 1959), to the Tax Court to determine whether the shareholders who gained control in that case really derived any financial or economic benefit.

The opinion's preoccupation with an assumed lack of resultant benefit to Schalk is a material defect as to not only the dividend issue, but as well the deduction issue. According to the Court, the $25,000 payment could not have qualified in any event as an ordinary and necessary business expense because "the payment was not beneficial to Schalk" (Op. p. 7).

IV.

The opinion overlooks certain critical facts having an important bearing on proper evaluation of the Tax Court's findings.

First: The fact that in less than 3 years the other shareholders would have automatically succeeded to control of Schalk upon termination of the trust, without acquiring Smith's 1/6th stock interest, is not discussed. This is material because it negates the Court's supposition that the other shareholders were motivated solely by a personal desire to acquire control of the company.

Second. The fact that the other shareholders wanted *the company* to pay the $25,000 to Smith in the first instance, but that Smith refused to involve himself personally with the company because the company was controlled by him, is not discussed. This is material because it demonstrates that the other shareholders did not want to deal with Smith, but had to if they were to protect the company. The company could not act itself. It could act only through Smith.

Third. The fact that the settlement eliminated a substantial controversy over management of the company (the Farmans were directors), which was shown to be seriously disrupting the company's business and operations, is not discussed. This is material because payments to stockholders to alleviate management dissension have been held to be deductible as business expenses and have been held not to constitute constructive dividends. See, *e.g., Boulevard Frocks, Inc.,* T. C. Memo. Dec. (1943); *Fred F. Fischer,* T. C. Memo. Dec. (1947).

Conclusion.

For the foregoing reasons, a rehearing should be granted in this case.

June 19, 1962.

Respectfully submitted,

Donald Keith Hall,

Attorney for Petitioners.

Certificate of Counsel.

As counsel of record for petitioners, I certify that in my judgment the foregoing Petition is well founded and that it is not interposed for delay.

DONALD KEITH HALL.

No. 16702

United States
Court of Appeals
for the Ninth Circuit

SCHALK CHEMICAL COMPANY, a Corporation; GERALD I. FARMAN, HAZEL I. FARMAN, JOHN CARVER BAKER and PATRICIA BAKER,

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Transcript of Record

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Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—3-25-60

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

DONALD KEITH HALL,
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For Petitioners.

CHARLES K. RICE,
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Tax Div. Dept. of Justice,
Washington 25, D.C.,

For Respondent.

The Tax Court of the United States

Docket No. 63853

SCHALK CHEMICAL COMPANY, a California Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1956

Aug. 20—Petition received and filed. Taxpayer notified. Fee paid.

Aug. 22—Copy of petition served on General Counsel.

Aug. 20—Request for Circuit hearing in Los Angeles, Calif., filed by Petr. 8/21/56 Granted. Served 8/22/56.

Oct. 2—Answer filed by resp. Served 10/4/56.

1958

Mar. 13—Notice of trial at L. A., Calif., June 23, 1958.

July 16-22—Trial before Judge Raum. Resp. oral motion to consolidate (63853, 55, 62) Granted. Stip. of Facts and Stip. of Facts-B, Resp. Trial Memo., filed at trial. Appearance of Donald K. Hall, filed at trial. Served subpoena of Horace O. Smith, Jr., and Henry O. Wackerbarth. Petr's Brief due Sept. 5, 1958. Reply Brief due Oct. 6, 1958. Answer to Reply due Oct. 27, 1958.

1958

July 28—Motion by Petr. for a 30 day extension of time to file opening brief. Granted 8/6/58.

Aug. 4—Transcript of Proceedings 7/16, 7/17, 7/18, 7/21, 7/22/58 filed. (5 Vols.).

Oct. 6—Petr's Brief filed. Served 10/7/58.

Nov. 5—Motion by Resp. for extension of time to Dec. 22, 1958, to file brief in answer. 11/6/58, Granted. Served 11/7/58.

Dec. 22—Brief for Resp. filed. Served 12/29/58.

1959

Jan. 7—Motion by petr. for extension of time to Feb. 2, 1959, to file reply brief. 1/9/59, Granted.

Feb. 2—Reply Brief filed by Petr. Served 2/5/59.

July 9—Findings of Fact and Opinion filed, Judge Raum. Decision will be entered for the Resp. Served 7/9/59.

July 21—Decision entered, Judge Raum. Served 7/22/59.

Oct. 19—Petition for Review by U.S.C.A., 9th Cir., filed by petr.

Oct. 19—Proof of service of pet. for rev. filed.

Oct. '26—Designation of Contents of Record with proof of service attached filed by petr.

Oct. 29—Motion by resp. for permission to substitute photostatic copies of certain orig. exs. 10/30/59, Granted. Served 11/3/59.

[Title of Tax Court.]

Docket No. 63855

GERALD I. FARMAN and HAZEL I. FARMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

[Docket Entries in the above title of cause and No. are identical to those set out in full in Docket No. 63853.]

[Title of Tax Court.]

Docket No. 63862

JOHN CARVER BAKER and PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

[Docket Entries in the above title of cause and No. are identical to those set out in full in Docket No. 63853.]

[Title of Tax Court and Cause.]

Docket No. 63853

PETITION

Petitioner Schalk Chemical Company, a California corporation, respectfully petitions the Tax Court of the United States for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated May 23, 1956, and in support of its petition alleges:

I.

Petitioner is a corporation organized and existing under the laws of the State of California, having its principal place of business at 351 East Second Street, Los Angeles 12, California. Petitioner's income tax return for the year 1950, with which this proceeding is concerned, was filed with the Collector of Internal Revenue for the Sixth District of Los Angeles, California.

II.

The notice of deficiency dated May 23, 1956 (copy of which is attached and marked Exhibit "A"), was mailed to Petitioner on or after the date of the notice.

III.

The Commissioner has determined a deficiency in income tax for the year 1950 in the amount of $15,087.22, all of which is in controversy.

IV.

The determination of tax liability set forth in the notice of deficiency is based on these errors:

(1) The Commissioner erred in disallowing the deduction of $45,000.00 claimed as a business expense on Petitioner's return for the year 1950.

(2) The Commissioner erred in disallowing the deduction of $3,697.92 claimed as interest expense on Petitioner's return for the year 1950.

V.

The facts upon which Petitioner relies in seeking a redetermination of the alleged deficiency are:

Preliminary Facts

(1) Petitioner filed a timely Federal income tax return for the year 1950, reporting a net loss of $692.79.

(2) Petitioner has issued and outstanding 100,000 shares of its capital stock, 16,666 of which since 1951 have been held as treasury shares.

The Trust

(3) From 1930 to 1950 the 100,000 outstanding shares of Petitioner were the principal asset of an express trust created on December 29, 1930. At all times material to this case prior to termination of the trust the beneficial interests of Petitioner's present shareholders totaled five-sixths and Horace O. Smith, Jr., held the remaining one-sixth beneficial interest in the trust.

(4) The declaration of trust designated alternate "Supervisors," each of whom while in office was to have the equivalent of plenary power of management over the trust and Petitioner, including the power and right to appoint a majority of the Board of Directors of Petitioner and the power and right to vote all the shares of Petitioner, all of which were to be issued in the name of the trustee bank, except shares needed to qualify the directors.

(5) In 1942 Horace O. Smith, Jr., then 28 years of age, succeeded to the office of Supervisor of the trust, being one of the designated alternates, and by virtue of that office thereafter and until 1948 dominated and controlled the Board of Directors of Petitioner and in consequence held domination and control of Petitioner.

(6) As a result of the domination and control of Petitioner by Horace O. Smith, Jr., his lack of experience and judgment and his unflinching refusal to heed the pleas of a majority of the beneficiaries of the trust, the business and reputation of Petitioner were adversely affected to an extremely serious and near catastrophic extent.

(7) From 1944 to 1948 the other beneficiaries of the trust employed every available means, including removal litigation, to neutralize the control of Petitioner by Horace O. Smith, Jr., for the benefit of Petitioner.

Settlement

(8) The lawsuit to remove Horace O. Smith, Jr., and the dispute between the beneficiaries concern-

ing the policies and management of Petitioner were settled by an agreement dated January 15, 1948, under which Horace O. Smith, Jr., resigned as Supervisor of the trust and as an officer and director of Petitioner and agreed to secure the resignations of the officers and directors of Petitioner whom he had caused to be elected and dominated.

(9) Without deviation, Horace O. Smith, Jr., insisted that the settlement agreement be with the other beneficiaries of the trust and not with Petitioner and that it include the purchase of his one-sixth beneficial interest for a price of $45,000.00, of which $25,000.00 was to be paid to him immediately and $20,000.00 on termination of the trust in 1950.

(10) The sole motivation of the other beneficiaries in entering into the agreement in 1948 with Horace O. Smith, Jr., was their desire to relieve Petitioner of the onerous and extremely detrimental effect of his domination and control of Petitioner.

(11) Pursuant to the agreement, but for the use and benefit of Petitioner, the other beneficiaries paid $25,000.00 to Horace O. Smith, Jr., in 1948 and his resignation and the resignations of his nominees were effectuated.

Assignment Agreement

(12) On December 29, 1950, under an authorizing resolution of its Board of Directors adopted on December 15, 1950, Petitioner entered into an assignment agreement with the other beneficiaries of

the trust under which their rights under the 1948 agreement were assigned to Petitioner and Petitioner assumed the obligation to pay $20,000.00 to Horace O. Smith, Jr., and agreed to reimburse with interest the $25,000.00 which had been paid to Horace O. Smith, Jr., in 1948 on behalf and for the use and benefit of Petitioner.

Deductions Claimed

(13) In its return for 1950 Petitioner deducted as a business expense the $45,000.00 which it agreed to pay pursuant to the assignment agreement.

(14) In its return for 1950 petitioner also deducted as interest expense $3,697.92 representing interest on the $25,000.00 expended on its behalf and for its protection in 1948 and for which Petitioner in 1950 agreed to make reimbursement.

Wherefore, Petitioner requests that the Honorable Tax Court hear this proceeding and determine:

(1) That the expense of $45,000.00 claimed by Petitioner in 1950 as an ordinary and necessary business expense incurred for the protection of Petioner's business was an allowable deduction;

(2) That the interest expense of $3,697.92 claimed by Petitioner in 1950 was an allowable deduction; and

(3) That there is no deficiency due from Petitioner for the year 1950.

Respectfully submitted,

/s/ HUGH W. DARLING,
Counsel for Petitioner.

Duly verified.

Received and filed August 20, 1956, T.C.U.S.

Served August 22, 1956.

[Title of Tax Court and Cause.]

Docket No. 63853

ANSWER

The Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I, II and III.

Admits the allegations contained in paragraphs I, II and III of the petition.

IV.

Denies the allegations of error contained in paragraph IV of the petition.

V.

(1) through (5). With regard to the facts upon which petitioner relies in seeking a redetermination of the alleged deficiency, admits the allegations contained in subparagraphs (1) through (5) of paragraph V of the petition.

(6) and (7) Denies the allegations contained in subparagraphs (6) and (7) of paragraph V of the petition.

(8) Admits the allegations contained in subparagraph (8) of paragraph V of the petition.

(9) through (12) Denies the allegations contained in subparagraphs (9) through (12) of paragraph V of the petition.

(13) Admits the allegations contained in subparagraph (13) of paragraph V of the petition.

(14) Denies the allegations contained in subparagraph (14) of paragraph V of the petition.

VI.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ JOHN POTTS BARNES,
R.E.M.
Chief Counsel, Internal
Revenue Service.

Of Counsel:
T. M. MATHER,
Acting Regional Counsel;
E. C. CROUTER,
Assistant Regional Counsel;

R. E. MAIDEN, JR.,
Special Assistant to the Regional Counsel;
JOSEPH G. WHITE, JR.,
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Los Angeles 13, California.

Filed October 2, 1956, T.C.U.S.

Entered October 4, 1956.

Served October 4, 1956.

[Title of Tax Court and Cause.]

Docket No. 63855

PETITION

Petitioners Gerald I. Farman and Hazel I. Farman respectfully petition the Tax Court of the United States for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated May 23, 1956, and in support of their petition allege:

I.

Petitioners are husband and wife and reside at 205 West Orange Grove Avenue, Sierra Madre, California. Their joint income tax return for the year 1951, with which this proceeding is concerned, was filed with the Collector of Internal Revenue for

the Sixth District of California, Los Angeles, California.

II.

The notice of deficiency dated May 23, 1956 (copy of which is attached and marked Exhibit "A"), was mailed to Petitioners on or after the date of the notice.

III.

The Commissioner has determined a deficiency in income tax for the year 1951 in the amount of $11,589.98, all of which is in controversy.

IV.

The determination of tax liability set forth in the notice of deficiency is based on these errors:

(1) The Commissioner erred in determining that Petitioners received dividends in the amount of $27,000.00 from Schalk Chemical Company in the year 1951.

(2) The Commissioner erred in determining that Petitioners omitted from their gross income for the year 1951 an amount in excess of 25% of the gross income reported by them.

V.

The facts upon which Petitioners rely in seeking a redetermination of the alleged deficiency are:

Preliminary Facts

(1) Petitioners filed a timely joint Federal income tax return for the year 1951, reporting a net income before exemptions of $14,341.63.

(2) Schalk Chemical Company is a corporation organized in 1903 and existing under the laws of the State of California, having its principal place of business at 351 East Second Street, Los Angeles, California, and has issued and outstanding 100,000 shares of its capital stock, 16,666 of which since 1951 have been held as treasury shares.

(3) Petitioner Hazel I. Farman in 1951 owned and now owns 50,000 shares of the capital stock of Schalk Chemical Company.

The Trust

(4) From 1930 to 1950 the outstanding shares of Schalk Chemical Company were the principal asset of an express trust created on December 29, 1930. At all times material to this case prior to the termination of the trust Petitioner Hazel I. Farman had a one-half beneficial interest and her son, Horace O. Smith, Jr., a one-sixth beneficial interest in the trust.

(5) The declaration of trust designated alternate "Supervisors," each of whom while in office was to have the equivalent of plenary power of management over the trust and Schalk Chemical Company, including the power and right to appoint a majority of the Board of Directors of Schalk Chemical Company and the power and right to vote all the shares of Schalk Chemical Company, all of which were to be issued in the name of the trustee bank, except shares needed to qualify the directors.

(6) In 1942 Horace O. Smith, Jr., then 28 years of age, succeeded to the office of Supervisor of the trust, being one of the designated alternates, and by virtue of that office thereafter and until 1948 dominated and controlled the Board of Directors of Schalk Chemical Company and in consequence held domination and control of Schalk Chemical Company.

(7) As a result of the domination and control of Schalk Chemical Company by Horace O. Smith, Jr., his lack of experience and judgment and his unflinching refusal to heed the pleas of a majority of the beneficiaries of the trust, the business and reputation of Schalk Chemical Company were adversely affected to an extremely serious and near catastrophic extent.

(8) From 1944 to 1948 the other beneficiaries of the trust employed every available means, including removal litigation, to neutralize the control of Schalk Chemical Company by Horace O. Smith, Jr.

Settlement

(9) The lawsuit to remove Horace O. Smith, Jr., and the dispute between the beneficiaries concerning the policies and management of Schalk Chemical Company were settled by an agreement dated January 15, 1948, under which Horace O. Smith, Jr., resigned as Supervisor of the trust and as an officer and director of Schalk Chemical Company and agreed to secure the resignations of the

officers and directors of Schalk Chemical Company whom he had caused to be elected and dominated.

(10) Without deviation, Horace O. Smith, Jr., insisted that the settlement agreement be with the other beneficiaries of the trust and not with the corporation and that it include the purchase of his one-sixth beneficial interest for a price of $45,000.00, of which $25,000.00 was to be paid to him immediately and $20,000.00 on termination of the trust in 1950.

(11) The sole motivation of the other beneficiaries in entering into the agreement in 1948 with Horace O. Smith, Jr., was their desire to relieve Schalk Chemical Company of the onerous and extremely detrimental effect of his domination and control of the company.

(12) Pursuant to the agreement, but for the use and benefit of Schalk Chemical Company, the other beneficiaries paid $25,000.00 to Horace O. Smith, Jr., in 1948 and his resignation and the resignations of his nominees were effectuated.

Assignment Agreement

(13) On December 29, 1950, under an authorizing resolution of its Board of Directors adopted on December 15, 1950, Schalk Chemical Company entered into an assignment agreement with the other beneficiaries of the trust under which their rights under the 1948 agreement were assigned to the com-

pany and the company assumed the obligation to pay $20,000.00 to Horace O. Smith, Jr., and agreed to reimburse with interest the $25,000.00 which had been paid to Horace O. Smith, Jr., in 1948 on behalf and for the benefit of the company.

(14) On termination of the trust Schalk Chemical Company received the distributive share of Horace O. Smith, Jr.

Dividend Issue

(15) In 1951, in pursuance of the assignment agreement, Schalk Chemical Company paid $20,000.00 to Horace O. Smith, Jr., and paid $25,000.00 to the other parties to the assignment agreement, of which Petitioner Hazel I. Farman received $15,000.00.

(16) No part of the $20,000.00 paid by Schalk Chemical Company to Horace O. Smith, Jr., or the $15,000.00 paid by Schalk Chemical Company to Petitioner Hazel I. Farman in 1951 was a dividend or a distribution essentially equivalent to a dividend to Petitioners.

Wherefore, Petitioners request that the Honorable Tax Court hear this proceeding and determine:

(1) That Petitioners received no dividend from Schalk Chemical Company in 1951; and

(2) That there is no deficiency due from Petitioners for the taxable year 1951.

Respectfully submitted,

/s/ HUGH W. DARLING,
Counsel for Petitioners.

Duly verified.

Received and filed August 20, 1956, T.C.U.S.

Served August 22, 1956.

[Title of Tax Court and Cause.]

Docket No. 63855

ANSWER

The Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayers, admits, denies, and alleges as follows:

I, II and III.

Admits the allegations contained in paragraphs I, II and III of the petition.

IV.

Denies the allegations of error contained in paragraph IV of the petition.

V.

With regard to the facts upon which petitioners rely in seeking a redetermination of the alleged deficiency,

(1) through (6) Admits the allegations contained in subparagraphs (1) through (6) of paragraph V of the petition.

(7) and (8) Denies the allegations contained in subparagraphs (7) and (8) of paragraph V of the petition.

(9) Admits the allegations contained in subparagraph (9) of paragraph V of the petition.

(10) through (13) Denies the allegations contained in subparagraphs (10) through (13) of paragraph V of the petition.

(14) Admits the allegations contained in subparagraph (14) of paragraph V of the petition.

(15) and (16) Denies the allegations contained in subparagraphs (15) and (16) of paragraph V of the petition.

VI.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Further answering the petition, the respondent alleges as follows:

VII.

That the petitioners filed their individual income tax return (joint) for the year 1951 on March 12, 1952; that in said return petitioners reported gross income in the amount of $17,364.38.

VIII.

That the petitioners had a gross income for the

said taxable year in the amount of $44,364.38; that there was omitted from the gross income so reported by petitioners in said year an amount properly includible therein of $27,000; that the last stated amount represented income derived by petitioners during said taxable year; that said amount is in excess of 25 per centum of the gross income stated in the return.

IX.

That within five years after the filing by petitioners of their return for the taxable year 1951, and on May 23, 1956, the Commissioner sent to the petitioners, by registered mail, the notice of deficiency from which petitioners' appeal is taken; that said notice of deficiency is the basis of the present proceeding.

X.

The premises considered, the involved notice of deficiency in respect of petitioners' taxable year 1951 was timely sent by the Commissioner to the petitioners.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioners' appeal denied.

/s/ JOHN POTTS BARNES, R.E.M.
Chief Counsel, Internal
Revenue Service.

Filed October 2, 1956, T.C.U.S.

Entered October 4, 1956.

Served October 4, 1956.

[Title of Tax Court and Cause.]

Docket No. 63862

PETITION

Petitioners John Carver Baker and Patricia Baker respectfully petition the Tax Court of the United States for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated May 23, 1956, and in support of their petition allege:

I.

In 1951 Petitioners were husband and wife. They now are divorced. Petitioner John Carver Baker resides at 2219 Ocean Avenue, Santa Monica, California. Petitioner Patricia Baker resides at 94 Esperanza, Sierra Madre, California. Their joint income tax return for the year 1951, with which this proceeding is concerned, was filed with the Collector of Internal Revenue for the Sixth District of California, Los Angeles, California.

II.

The notice of deficiency dated May 23, 1956 (copy of which is attached and marked Exhibit "A"), was mailed to Petitioners on or after the date of the notice.

III.

The Commissioner has determined a deficiency in income tax for the year 1951 in the amount of $2,465.86, all of which is in controversy.

IV.

The determination of tax liability set forth in the notice of deficiency is based on these errors:

(1) The Commissioner erred in determining that Petitioners received dividends in the amount of $9,000.00 from Schalk Chemical Company in the year 1951.

(2) The Commissioner erred in determining that Petitioners omitted from their gross income for the year 1951 an amount in excess of 25% of the gross income reported by them and in failing to find that assessment of additional income tax for the year 1951 is barred by Section 275 (a) of the Internal Revenue Code of 1939.

V.

The facts upon which Petitioners rely in seeking a redetermination of the alleged deficiency are:

Preliminary Facts

(1) Petitioners filed a timely joint Federal income tax return for the year 1951, reporting an adjusted gross income of $5,620.55.

(2) Schalk Chemical Company is a corporation organized in 1903 and existing under the laws of the State of California, having its principal place of business at 351 East Second Street, Los Angeles, California, and has issued and outstanding 100,000 shares of its capital stock, 16,666 of which since 1951 have been held as treasury shares.

(3) Petitioner Patricia Baker in 1951 owned

and now owns 16,667 shares of the capital stock of Schalk Chemical Company.

The Trust

(4) From 1930 to 1950 the outstanding shares of Schalk Chemical Company were the principal asset of an express trust created on December 29, 1930. At all times material to this case prior to the termination of the trust Petitioner Patricia Baker had a one-sixth beneficial interest and her brother, Horace O. Smith, Jr., a one-sixth beneficial interest in the trust.

(5) The declaration of trust designated alternate "Supervisors," each of whom while in office was to have the equivalent of plenary power of management over the trust and Schalk Chemical Company, including the power and right to appoint a majority of the Board of Directors of Schalk Chemical Company and the power and right to vote all the shares of Schalk Chemical Company, all of which were to be issued in the name of the trustee bank, except shares needed to qualify the directors.

(6) In 1942 Horace O. Smith, Jr., then 28 years of age, succeeded to the office of Supervisor of the trust, being one of the designated alternates, and by virtue of that office thereafter and until 1948 dominated and controlled the Board of Directors of Schalk Chemical Company and in consequence held domination and control of Schalk Chemical Company.

(7) As a result of the domination and control of Schalk Chemical Company by Horace O. Smith, Jr., his lack of experience and judgment and his unflinching refusal to heed the pleas of a majority of the beneficiaries of the trust, the business and reputation of Schalk Chemical Company were adversely affected to an extremely serious and near catastrophic extent.

(8) From 1944 to 1948 the other beneficiaries of the trust employed every available means, including removal litigation, to neutralize the control of Schalk Chemical Company by Horace O. Smith, Jr.

Settlement

(9) The lawsuit to remove Horace O. Smith, Jr., and the dispute between the beneficiaries concerning the policies and management of Schalk Chemical Company were settled by an agreement dated January 15, 1948, under which Horace O. Smith, Jr., resigned as Supervisor of the trust and as an officer and director of Schalk Chemical Company and agreed to secure the resignations of the officers and directors of Schalk Chemical Company whom he had caused to be elected and dominated.

(10) Without deviation, Horace O. Smith, Jr., insisted that the settlement agreement be with the other beneficiaries of the trust and not with the corporation and that it include the purchase of his one-sixth beneficial interest for a price of $45,000.00, of which $25,000.00 was to be paid to him immedi-

ately and $20,000.00 on termination of the trust in 1950.

(11) The sole motivation of the other beneficiaries in entering into the agreement in 1948 with Horace O. Smith, Jr., was their desire to relieve Schalk Chemical Company of the onerous and extremely detrimental effect of his domination and control of the company.

(12) Pursuant to the agreement, but for the use and benefit of Schalk Chemical Company, the other beneficiaries paid $25,000.00 to Horace O. Smith, Jr., in 1948 and his resignation and the resignations of his nominees were effectuated.

Assignment Agreement

(13) On December 29, 1950, under an authorizing resolution of its Board of Directors adopted on December 15, 1950, Schalk Chemical Company entered into an assignment agreement with the other beneficiaries of the trust under which their rights under the 1948 agreement were assigned to the company and the company assumed the obligation to pay $20,000.00 to Horace O. Smith, Jr., and agreed to reimburse with interest the $25,000.00 which had been paid to Horace O. Smith, Jr., in 1948 on behalf and for the benefit of the company.

(14) On termination of the trust Schalk Chemical Company received the distributive share of Horace O. Smith, Jr.

Dividend Issue

(15) In 1951, in pursuance of the assignment agreement, Schalk Chemical Company paid $20,000.00 to Horace O. Smith, Jr., and paid $25,000.00 to the other parties to the assignment agreement, of which Petitioner Patricia Baker received $5,000.00.

(16) No part of the $20,000.00 paid by Schalk Chemical Company to Horace O. Smith, Jr., or the $5,000.00 paid by Schalk Chemical Company to Petitioner Patricia Baker in 1951 was a dividend or a distribution essentially equivalent to a dividend to Petitioners.

Wherefore, Petitioners request that the Honorable Tax Court hear this proceeding and determine:

(1) That Petitioners received no dividend from Schalk Chemical Company in 1951;

(2) That assessment of additional income tax for the year 1951 is barred by Section 275 (a) of the Internal Revenue Code of 1939; and

(3) That there is no deficiency due from Petitioners for the taxable year 1951.

Respectfully submitted,

/s/ HUGH W. DARLING,
Counsel for Petitioners.

Duly verified.

Received and filed August 20, 1956, T.C.U.S.

Served August 22, 1956.

[Title of Tax Court and Cause.]

Docket No. 63862

ANSWER

The Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, for answer to the petition of the above-named taxpayers, admits, denies, and alleges as follows:

I, II and III.

Admits the allegations contained in paragraphs I, II and III of the petition.

IV.

Denies the allegations of error contained in paragraph IV of the petition.

V.

(1) through (6) With regard to the facts upon which petitioners rely in seeking a redetermination of the alleged deficiency, admits the allegations contained in subparagraphs (1) through (6) of paragraph V of the petition.

(7) and (8) Denies the allegations contained in subparagraphs (7) and (8) of paragraph V of the petition.

(9) Admits the allegations contained in subparagraph (9) of paragraph V of the petition.

(10) through (13) Denies the allegations contained in subparagraphs (10) through (13) of paragraph V of the petition.

(14) Admits the allegation contained in subparagraph (14) of paragraph V of the petition.

(15) and (16) Denies the allegations contained in subparagraphs (15) and (16) of paragraph V of the petition.

VI.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Further answering the petition, the respondent alleges as follows:

VII.

That the petitioners filed their individual income tax return (joint) for the year 1951 on March 15, 1952; that in said return petitioners reported gross income in the amount of $6,740.55.

VIII.

That the petitioners had a gross income for the said taxable year in the amount of $15,740.55; that there was omitted from the gross income so reported by petitioners in said year an amount properly includible therein of $9,000; that the last stated amount represented income derived by petitioners during said taxable year; that said amount is in excess of 25 per centum of the gross income stated in the return.

IX.

That within five years after the filing by petitioners of their return for the taxable year 1951, and on May 23, 1956, the Commissioner sent to the petitioners, by registered mail, the notice of deficiency from which petitioners' appeal is taken; that said notice of deficiency is the basis of the present proceeding.

X.

The premises considered, the involved notice of deficiency in respect of petitioners' taxable year 1951 was timely sent by the Commissioner to the petitioners.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioners' appeal denied.

/s/ JOHN POTTS BARNES, R.E.M.
Chief Counsel, Internal
Revenue Service.

Filed October 2, 1956, T.C.U.S.

Entered October 4, 1956.

Served October 4, 1956.

[Title of Tax Court and Cause.]

Dockets Nos. 63853, 63855 and 63862

STIPULATION OF FACTS

It Is stipulated and agreed by and between the parties hereto, through their respective counsel of

record, that for the purposes of the above cases the facts stated herein shall be taken as true and the exhibits attached hereto shall be admissible in evidence without further foundation, subject to the right of either party to object to the admission of such evidence on the grounds of materiality and relevancy; provided, however, that either party may introduce other and further evidence not inconsistent with the evidence herein stipulated:

1. Petitioner Schalk Chemical Company (referred to herein as "Schalk") is a corporation organized and existing under the laws of the State of California. Schalk was incorporated on October 9, 1903.

2. Petitioner Hazel I. Farman was the wife of Horace O. Smith until his death on December 9, 1928. They were the parents of petitioner Patricia Farman Baker (born September 14, 1925), Evelyn Smith Marlow (born February 1, 1913), and Horace O. Smith, Jr. (born December 13, 1913). Hazel I. Farman became the wife of petitioner Gerald I. Farman on August 14, 1931. Petitioner John Carver Baker is the former husband of Patricia Farman Baker.

3. At all times material to these cases, the accounts and income of Schalk have been maintained and reported on a calendar-year, accrual basis, and the accounts and income of the individual petitioners have been maintained and reported on a calendar-year, cash basis.

4. At all times material to these cases prior to 1951 Schalk had issued and outstanding 100,000 shares of its capital stock. In 1951 Schalk acquired the 16,666 shares now held in its treasury.

5. The present shareholders of Schalk and the number of shares of the capital stock of Schalk owned by each are:

Hazel I. Farman.....50,000 shares
Patricia Farman Baker.....16,667 shares
Evelyn Smith Marlow.....16,667 shares

6. From December 29, 1930, to December 29, 1950, the 100,000 issued and outstanding shares of Schalk were the principal asset of an express trust (referred to herein as the "trust") created on December 29, 1930. A true copy of the Declaration of Trust by which the trust was created is attached hereto as Exhibit "1."

7. Horace O. Smith, the father of Patricia Farman Baker, Evelyn Smith Marlow and Horace O. Smith, Jr., died testate on December 9, 1928. The trust referred to in paragraph 6 was created in pursuance of a Stipulation and Agreement dated September 26, 1929, entered into in settlement of a will contest filed by Hazel I. Farman and in pursuance of the Final Decree of Distribution in the Matter of the Estate of Horace O. Smith, Deceased, Los Angeles Superior Court No. 100125, in which the Stipulation and Agreement was incorporated. Ratification of the Stipulation and Agreement by

the guardian of the minor children was authorized by Order dated November 29, 1929, in the Matter of the Guardianship of the children, Los Angeles Superior Court No. 103528.

8. The term of the trust expired on December 29, 1950, in accordance with the provisions of the Declaration of Trust and the corpus of the trust was distributed to the beneficiaries in 1951.

9. Three "Supervisors" were named in the Declaration of Trust to serve severally in the order named. The first, Frank A. Maginnis, refused to serve. The second, Curtis C. Colyear, served as Supervisor of the trust from 1930 until his decease in 1943. The third, Horace O. Smith, Jr., held that office from 1943 until his resignation in 1948. He was succeeded by Stanley W. Guthrie, who in 1948 was appointed Supervisor of the trust by Court order in the Matter of the Estate of Horace O. Smith, Deceased, Los Angeles Superior Court No. 100125. Stanley W. Guthrie acted as Supervisor for the balance of the term of the trust.

10. Pursuant to the designation of Curtis C. Colyear, then Supervisor of the trust and President of Schalk, Horace O. Smith, Jr., was elected director of Schalk in 1939. In 1942 Horace O. Smith, Jr., was elected President of Schalk. Horace O. Smith, Jr., remained director and President of Schalk until his resignation of those offices on January 15, 1948.

11. On September 26, 1945, G. I. Farman was

elected a director of Schalk at the instance of Evelyn Smith Marlow and Patricia Farman Baker pursuant to the power to designate a director reserved to them under the Declaration of Trust. Thereafter and until the first election of directors following the termination of the trust on December 29, 1950, G. I. Farman served as a director of Schalk as designee of Evelyn Smith Marlow and Patricia Farman Baker.

12. On April 11, 1947, Evelyn Smith Marlow and Patricia Farman Baker filed an action in the Superior Court of the State of California in and for the County of Los Angeles, No. 528,107. True copies of the pleadings (exhibits thereto omitted), memoranda, stipulations, minute orders, dismissal as to certain parties, stipulated judgment and notice of entry of judgment filed and entered in said action are collectively attached hereto as Exhibit "2." Original stipulations executed but not filed with the Court in said action are collectively attached hereto as Exhibit "3."

13. On January 15, 1948, concurrently with and in pursuance of an agreement executed and entered into on that date:

(a) Horace O. Smith, Jr., resigned as Supervisor of the trust and as director and President of Schalk.

(b) Henry O. Wackerbarth resigned as director and Secretary of and as Attorney for Schalk.

(c) Henry J. Rausch resigned as director and Auditor of Schalk.

(d) Hazel I. Farman, Evelyn Smith Marlow and Patricia Farman Baker executed and delivered releases in favor of the persons named in (a), (b) and (c), and in favor of Howard Lieben and Elmer J. Jensen, former directors of Schalk. True copies of the releases are collectively attached hereto as Exhibit "4."

(e) Horace O. Smith, Jr., was paid and received the sum of $25,000.00.

14. On December 15, 1950, the Board of Directors of Schalk held a meeting, a true copy of the minutes of which is attached hereto marked Exhibit "5."

15. In 1951 Schalk paid the sum of $20,000.00 to Horace O. Smith, Jr., the sum of $17,364.38 to Hazel I. Farman, and the sum of $5,788.13 each to Patricia Farman Baker and Evelyn Smith Marlow. Of such sums, the amount of $2,364.38 paid to Hazel I. Farman and the amounts of $788.13 paid to Patricia Farman Baker and Evelyn Smith Marlow, respectively, are claimed by Schalk to be interest at the rate of 5% per annum from January 15, 1948.

* * *

17. As of December 31, 1947, the book value of the issued and outstanding stock of Schalk was $1.33 per share.

18. Post-1913 accumulated earnings and profits of Schalk as of December 31 1949, amounted to $68,956.10.

19. For the calendar year 1950, Schalk filed a Federal Income Tax Return in which it deducted, among other deductions, the sum of $45,000.00 as a business expense and the sum of $3,697.92 as accrued interest. The tax return shows a net loss of $692.79. The Commissioner has disallowed both of these deductions (the interest being disallowed specifically under Section 23(b) of the Internal Revenue Code of 1939), and the alleged deficiency in tax resulting from such adjustments is $15,087.22. If the Commissioner's disallowances be sustained in full, then Schalk would have a net taxable income of $47,603.13 for the year 1950 instead of a loss. No formal dividends were declared or paid by Schalk in 1950. Schalk's Federal Income Tax Return for the year 1950 is attached hereto as Exhibit "A."

20. For the calendar year 1951 petitioners Gerald I. Farman and Hazel I. Farman filed a joint Federal Income Tax Return in which the Commissioner contends they should have included the sum of $27,000 (3/5ths of $45,000) as dividend income from Schalk. The alleged deficiency in tax resulting from the adjustment is $11,589.98. Mr. and Mrs. Farman's Federal Income Tax Return for the calendar year 1951 is attached hereto as Exhibit "B."

21. For the calendar year 1951 petitioners John Carver Baker and Patricia Farman Baker filed a

joint Federal Income Tax Return in which they reported adjusted gross income of $5,620.55. The Commissioner has treated the sum of $9,000 (1/5th of $45,000) as properly includible but omitted dividend income from Schalk and has disallowed $520.00 of claimed automobile expense. In addition, these petitioners omitted interest in the sum of $788.13 paid to them by Schalk in 1951. The alleged deficiency in tax resulting from these adjustments is $2,465.86. Mr. and Mrs. Baker's Federal Income Tax Return for the calendar year 1951 is attached hereto as Exhibit "C."

22. No consents extending the statutory period of assessment for any of the years in question were executed by any of the taxpayers involved herein, except Schalk. A consent extending until June 30, 1955, the period of assessment of income taxes for the taxable year ended December 31, 1950, was executed by Schalk on November 23, 1953, and by the Commissioner on December 1, 1953. A consent extending until June 30, 1956, the period of assessment of income taxes for the taxable year ended December 31, 1950, was executed by Schalk on June 13, 1955, and by the Commissioner on June 24, 1955.

23. The notices of deficiency which are the subject of these cases were issued on May 23, 1956. The petitions herein were filed on August 20, 1956.

HUGH W. DARLING, and
DONALD KEITH HALL,

By /s/ DONALD KEITH HALL,
Counsel for Petitioners.

/s/ ARCH M. CANTRALL, R.E.M.
Chief Counsel, Internal
Revenue Service.

Filed at trial July 16, 1958.

[Title of Tax Court and Cause.]

Dockets Nos. 63853, 63855 and 63862

STIPULATION OF FACTS—B

It is stipulated and agreed by and between the parties hereto, through their respective counsel of record, that for the purposes of the above cases the facts stated herein shall be taken as true:

1. Horace O. Smith, Deceased, at his death on December 9, 1928, owned 49,934 shares of the capital stock of Schalk Chemical Company. On that date, Sierra Chemical Company, a California corporation, owned 50,000 shares of the capital stock of Schalk Chemical Company. The total capital stock of Schalk Chemical Company on December 9, 1928, consisted of 100,000 shares.

2. Horace O. Smith, Deceased, at his death on December 9, 1928, also owned 55,000 shares of the capital stock of Sierra Chemical Company. On that date, the remaining 45,000 shares outstanding of the capital stock of Sierra Chemical Company were

owned by Graselli Chemical Company, an Ohio corporation.

3. After the death of Horace O. Smith, the Executor of his Estate acquired the 45,000 shares of the capital stock of Sierra Chemical Company which were owned by Graselli Chemical Company and thereafter caused Sierra Chemical Company to be dissolved.

July 28, 1958.

HUGH W. DARLING, and
DONALD KEITH HALL,

By /s/ DONALD KEITH HALL,
Counsel for Petitioners.

/s/ ARCH M. CANTRALL, R.E.M.
Chief Counsel, Internal
Revenue Service.

Filed at trial July 22, 1958.

[Title of Tax Court and Cause.]

Dockets Nos. 63853, 63855, 63862

FINDINGS OF FACT AND OPINION

1. Corporation, on an accrual basis, held not entitled to deduct as an ordinary and necessary business expense a liability it voluntarily assumed in 1950 to reimburse three beneficiaries of a spendthrift trust, which held all of its stock, for a down payment of $25,000 made by them in 1948, pur-

suant to the terms of an agreement with S, the fourth beneficiary, wherein S agreed to sell, and they agreed to buy, for $45,000, his one-sixth minority interest in the stock of the corporation at the termination of the trust.

2. Corporation held not to be entitled to deduct as an ordinary and necessary expense, or as interest, the amount of the liability it assumed in 1950 to reimburse the three beneficiaries for the interest they had paid on money borrowed to make the $25,000 down payment.

3. Three beneficiaries held to have received a dividend from corporation to the extent that they participated in the distribution made by it in 1951, to reimburse them for the $25,000 down payment.

4. Three beneficiaries held to have received a distribution essentially equivalent to the distribution of a dividend in 1951, when the corporation satisfied their contractual obligation to pay the $20,000 balance of the purchase price of S's one-sixth minority stock interest at the termination of the trust.

5. Assessment of deficiencies determined against individual petitioners held not barred by statute of limitations.

Donald K. Hall, Esq., for the petitioners.

Marion Malone, Esq., and J. Earl Gardner, Esq., for the respondent.

Respondent determined the following deficiencies in income tax:

Year	Docket Number	Petitioner	Deficiency
1950	63853	Schalk Chemical Company	$15,087.22
1951	63855	Gerald I. Farman and Hazel I. Farman	11,589.98
1951	63862	John Carver Baker and Patricia Baker	2,465.86

The issues are:

1. Was the amount of $45,000 paid by Schalk Chemical Company to Hazel I. Farman, Patricia Baker, Evelyn Marlow and Horace O. Smith, Jr., or any part thereof, deductible by it as a business expense in 1950?

2. Was the amount of $3,697.92, paid by Schalk Chemical Company to Hazel I. Farman, Patricia Baker and Evelyn Marlow, deductible by it as interest, or as a business expense, in 1950?

3. Was the amount of $25,000 paid by the Schalk Chemical Company to Hazel I. Farman, Patricia Baker and Evelyn Marlow during the year 1951, a dividend?

4. Did any part of the $20,000 paid by Schalk Chemical Company in 1951 to Horace O. Smith, Jr., constitute a dividend, or a distribution essentially equivalent to a dividend, to Hazel I. Farman and Patricia Baker, or either of them?

5. Did petitioners John Carver Baker and Patricia Baker and petitioners Gerald I. Farman

and Hazel I. Farman omit from their gross income for the year 1951, an amount properly includible therein which is in excess of 25 per centum of gross income stated in their returns?

Findings of Fact

Some of the facts have been stipulated and, as stipulated, they are incorporated herein by reference.

Schalk Chemical Company (hereinafter referred to as "Schalk") was organized in 1903 under the laws of the State of California. It manufactures and distributes nationally a line of associated paint products and home repair products. Its books were kept and its returns filed on an accrual basis.

Schalk filed its Federal income tax return for the year 1950 with the then collector of internal revenue, Los Angeles, California. In that return it deducted, among other expenses, the amount of $45,000 as a business expense and the amount of $3,697.92 as accrued interest. Respondent disallowed both of these deductions (the interest being disallowed under Section 23(b) of the Internal Revenue Code of 1939).

Gerald I. Farman and Hazel I. Farman, husband and wife, filed a joint income tax return for the year 1951, on March 12, 1952, with the then collector of internal revenue at Los Angeles, California. Therein they reported gross income of $17,364.38 and net income of $14,341.63. Respondent deter-

mined that they received from Schalk during 1951, dividends of $27,000 (3/5ths of $45,000), and the deficiency determined against them results from the addition of this amount to the net income reported in their 1951 return.

John Carver Baker and Patricia Baker, then husband and wife, filed a joint income tax return for the year 1951, on March 15, 1952, with the then collector of internal revenue, Los Angeles, California. In this return they reported gross income of $6,740.55 and net income of $5,058.49. In determining the deficiency against them, the respondent adjusted the net income reported in their return by disallowing $520 of claimed automobile expense and adding $788.13 for omitted interest income and $9,000 (1/5th of $45,000) for dividends received from Schalk during 1951. Petitioners do not contest the automobile expense and interest adjustments.

Respondent's notices of deficiency to petitioners were issued on May 23, 1956. The petitioners filed their petitions in this Court on August 20, 1956.

Consents extending until June 30, 1956, the period of assessment of income taxes for the year 1950, were executed by Schalk and respondent. No consents extending the period of assessment for any of the taxable years were executed by the other petitioners.

In 1928 Horace O. Smith died testate, being survived by his widow, Hazel I. Smith (now Hazel I. Farman); their three children, Evelyn Smith (now

Evelyn Smith Marlow), Horace O. Smith, Jr., and Patricia Smith (now Patricia Baker); and his mother, Charlotte E. Wood. The children were minors at the time, being 15, 14 and 3 years of age, respectively.

A will contest was filed by decedent's widow which was settled by a Stipulation and Agreement dated September 26, 1929. Pursuant to the Stipulation and Agreement and Final Decree of Distribution in the Estate of Horace O. Smith, Deceased, Los Angeles Superior Court No. 100125, a spendthrift trust was created, the principal asset of which consisted of all the then issued and outstanding stock (100,000 shares) of Schalk.

The trust came into being on December 29, 1930, for a term of twenty years, expiring on December 29, 1950.

The beneficiaries of the trust were Hazel I. Smith (now Hazel I. Farman), Charlotte E. Wood, Evelyn Smith (now Evelyn Smith Marlow), Horace O. Smith, Jr., and Patricia Smith (now Patricia Baker). Hazel I. Smith became the wife of petitioner Gerald I. Farman on August 14, 1931.

After the demise of Charlotte E. Wood, prior to 1940 (the children succeeding to her 12½ per cent interest pro rata) and until termination of the trust on December 29, 1950, the beneficial interests were:

Hazel I. Farman	50 per cent
Evelyn Smith Marlow	16⅔ per cent

Horace O. Smith, Jr. ..... 16⅔ per cent
Patricia Baker ..... 16⅔ per cent

The Declaration of Trust appointed three persons to serve successively as "supervisor," each of whom while in office was to have the equivalent of absolute power of management over the trust and Schalk, including the power and right to appoint a majority (three out of a total of five members), of the Board of Directors of Schalk and the power and right to vote all the shares of Schalk.

The first named supervisor refused to serve. The second, Curtis C. Colyear, served from 1930 until his decease in 1943. The third, Horace O. Smith, Jr., held the office until his resignation in 1948. He was succeeded by Stanley W. Guthrie, who was appointed by Court order and who acted as supervisor for the remainder of the term of the trust.

As supervisor of the trust and director and President of Schalk from 1943 to 1948, and through officers and directors which he caused to be elected, Horace O. Smith, Jr., dominated and controlled the Board of Directors of Schalk and in consequence dominated and controlled the management and policies of Schalk.

Hazel I. Farman was a "minority director" by virtue of the terms of the Declaration of Trust. Gerald I. Farman was appointed a "minority director" in 1945 by Evelyn Smith Marlow and Patricia Baker, pursuant to the power to designate

a director reserved to them under the Declaration of Trust.

After Smith became supervisor of the trust and president of Schalk, the other beneficiaries of the trust made a number of suggestions to Smith and the officers and directors of Schalk he had caused to be appointed which they thought were in the best interests of Schalk. These suggestions related in part to sales promotion, new products, advertising costs, and automatic equipment. Because of the failure of the corporation to adopt and follow many of these suggestions controversies arose between Smith and the other beneficiaries of the trust. Attempts to settle these controversies by setting up an executive committee composed of Smith, Hazel I. Farman, and Gerald I. Farman (Smith's stepfather) to manage the company and by permitting Gerald I. Farman to fill the position of vice president and expediter of raw materials, were unsuccessful. In April, 1947, Evelyn Smith Marlow and Patricia Baker filed suit to remove Smith, as supervisor of the trust. This suit and the controversy between Smith and the other beneficiaries of the trust were settled, after extended negotiations, by an agreement dated January 15, 1948 (hereinafter sometimes referred to as the settlement agreement), resulting in the elimination of Smith's interest in and control over Schalk and the payment to Smith of $25,000 in 1948 and $20,000 in 1951. During the course of the negotiations leading to the settlement agreement, the other beneficiaries of the trust pro-

posed that the settlement be by agreement between Smith and Schalk. Smith rejected their proposals that Schalk be a party to the agreement or pay any part of the money which he was demanding. He insisted upon dealing directly with the other beneficiaries.

The foregoing settlement agreement of January 15, 1948, by and between Horace O. Smith, Jr., First Party, and Hazel I. Farman, Evelyn Smith Marlow and Patricia Farman Baker, Second Parties, provided in part as follows:

For and in consideration of the sum of $25,000 to First Party in hand paid by Second Parties, receipt of said sum being hereby acknowledged by First Party, First Party agrees to sell to Second Parties jointly and severally, and Second Parties jointly and severally agree to buy from First Party, subject to the terms and conditions herein contained, upon the termination and distribution of that certain trust dated December 29, 1930 * * * all of the then right, title and interest of First Party in and to the corpus and any accumulations thereof then belonging or distributed to First Party.

On or before thirty days after the termination of said Trust No. 1071 (which said termination date is hereby agreed as being the 29th day of December, 1950), and the actual distribution by the trustee of the corpus and accumulated assets of the trust estate to the beneficiaries then entitled to receive the same, Second Parties jointly and severally agree

to pay to First Party the sum of $20,000 in then current funds of the United States of America, less the amount of any distribution of any type or character whatsoever, including income, made by said trustee to First Party subsequent to the date hereof and prior to the date of final distribution of the trust estate.

It is understood and agreed that this agreement shall not be intended or construed as an assignment or transfer by First Party of any present right, title or interest of First Party in or to said trust or to the corpus or income thereof, and that no transfer of any interest of First Party in or to said trust, or in or to any corpus or income therefrom, shall be made by First Party until said trust has terminated and the corpus and any accumulated income thereon shall have been distributed to First Party.

It is distinctly understood and agreed that First Party agrees to sell and Second Parties agree to buy all of the assets of said Trust No. 1071 distributed to First Party upon the termination of said trust in whatever form said assets distributable to First Party may then exist, including cash, stocks, securities and real and personal property of every kind, nature and description whatsoever. In the event that First Party's beneficial or distributable interest in said trust shall for any reason be increased by reason of the terms and provisions of said trust agreement subsequent to the date hereof and prior to the actual distribution to First Party, such increase shall be included as a part of the prop-

erty to be transferred by First Party to Second Parties hereunder.

Within five days after actual distribution by the trustee of said trust to First Party of the property herein agreed to be sold to Second Parties, or notice that said beneficial interest of First Party in said trust is ready for distribution to First Party, First Party agrees to deposit into an escrow to be opened with Security-First National Bank of Los Angeles or Bank of America National Trust and Savings Association, in the City of Los Angeles, all of the property of every kind, nature and description received by First Party and agreed to be sold hereunder, together with such bills of sale, deeds, conveyances, assignments, or other instruments as may be necessary to vest title thereto in Second Parties, with instructions to deliver all thereof to Second Parties or their assignees upon the payment to First Party of the sum of $20,000.00, less the amount of any distributions made to First Party from said trust subsequent to the date hereof as hereinbefore provided. First Party shall likewise deposit concurrently in said escrow an itemized statement of any such distributions made to him by said trust and shall notify Second Parties of the opening of said escrow.

Second Parties agree within twenty-five days after the receipt of such notice to deposit into such escrow the balance of the purchase price herein provided, and upon receipt of said sum said escrow holder shall be instructed to close said escrow and

distribute the remainder of said purchase price to First Party, and the property herein provided to be sold to Second Parties or their assigns, the costs and expenses of said escrow to be paid by Second Parties. Any taxes assessed against the transfer of all property to be sold by First Party hereunder shall be paid by First Party promptly when due.

Said escrow instructions shall provide that if Second Parties or their assigns fail, neglect or refuse to deposit in the aforesaid escrow, within the time and subject to the conditions herein contained, the balance remaining of the aforesaid purchase price, then all property and documents deposited by First Party in said escrow shall immediately be returned to First Party on demand and said escrow shall be terminated.

In consideration of First Party agreeing to resign as supervisor of the trust hereinbefore described and as officer and director of Schalk Chemical Company, a corporation, and of his securing the resignation of Henry O. Wackerbarth as an officer, director and attorney for said corporation, and of H. T. Rausch as a director and auditor of said corporation, the parties hereto agree to enter into a stipulation for the entry of a judgment in the action in the Superior Court of the State of California in and for the County of Los Angeles, entitled Evelyn Smith Marlow and Patricia Farman Baker, as Plaintiffs, vs. Union Bank and Trust Co. of Los Angeles, a corporation, et al., as Defendants, and numbered 528,107 in said Court, which

said stipulation is being entered into concurrently herewith.

In the event that Second Parties, their heirs, successors, or assigns, shall fail, neglect or refuse to pay the balance of the purchase price as herein provided, First Party shall be released from any and all obligation to sell, transfer, convey or assign the property herein described, and Second Parties, their heirs, successors and assigns, shall be released of any and all obligations to purchase said property or to pay to First Party any additional moneys hereunder.

The entire purchase price for the property herein agreed to be sold by First Party to Second Parties shall be the sum of $45,000.00, less any distributions made by First Party from said trust as herein provided, and the sum of $25,000.00 paid by Second Parties as consideration to First Party for entering into this agreement shall, in the event Second Parties, their heirs, successors or assigns, comply fully and promptly with the terms and conditions hereof, be applied towards said total purchase price.

This agreement may be assigned by Second Parties, their heirs, successors and assigns, at any time during the term hereof.

First Party agrees, immediately upon request from Second Parties so to do, to apply for and use his best efforts to secure a policy of life insurance insuring the life of First Party, in such form and with such insurance company as Second Parties

may request, in the principal sum of $25,000.00, with Second Parties as joint and several beneficiaries thereunder. Second Parties jointly and severally agree to pay the initial and all subsequent premiums and costs in connection with the securing of said policy, and immediately upon the issuance thereof, said policy shall be delivered to and become the property of Second Parties, First Party assuming no liability as to the payment of premiums thereon. Any dividends on said policy shall become the property of Second Parties and no change of beneficiaries shall be made without the consent of Second Parties, First Party hereby agreeing to join in and consent to any change of beneficiaries upon request of Second Parties so to do.

Time is to be and is of the essence of this agreement.

This agreement shall inure to the benefit of the heirs, executors and assigns of the parties hereto.

At a special meeting of the board of directors of Schalk, held on January 15, 1948, Horace O. Smith, Jr., presented to the board his resignation as supervisor of the trust and as an officer and director of Schalk and also the resignations of the officers and directors of Schalk whom he had caused to be elected, and resolutions were adopted accepting these resignations.

On January 15, 1948, Hazel I. Farman, Patricia Baker, and Evelyn Smith Marlow paid Horace O. Smith, Jr., the amount of $25,000. Hazel I. Farman

paid $15,000, and Patricia Baker and Evelyn Smith Marlow each paid $5,000. Hazel I. Farman and Patricia Baker borrowed the money to make their portions of the $25,000 payment. The promissory notes given by them for the loans were due and payable on or before January 15, 1951, and bore interest at the rate of five per cent per annum.

As of December 31, 1947, the book value of the issued and outstanding stock of Schalk was $1.33 per share. Schalk had done a considerable amount of advertising over a long period of years, and it was the concensus of its board of directors that it had established an extensive good will for its products. No amount for good will was shown on its books.

By resolution of the board of directors of Schalk, adopted on December 15, 1950, Schalk was authorized to accept an assignment of the settlement agreement as of December 29, 1950, provided Horace O. Smith, Jr., survived that date; to assume the obligations to Hazel I. Farman, Evelyn Smith Marlow and Patricia Baker under the settlement agreement; to pay them the amount of $25,000 with interest at five per cent from January 15, 1948; and to pay to Smith the amount of $20,000 upon delivery to Schalk of all the property received by Smith as a distributive beneficiary of the trust.

As of December 29, 1950, Hazel I. Farman, Evelyn Smith Marlow and Patricia Baker, as "First Parties" and Schalk as "Second Party" entered into an agreement. Therein the First Parties as-

signed to Schalk all of their rights and interests in the settlement agreement of January 15, 1948; Schalk accepted the assignment and assumed and agreed to be bound by all of the obligations of Hazel I. Farman, Evelyn Smith Marlow and Patricia Baker therein; and Schalk agreed to pay them the amount of $25,000, plus interest at five per cent per annum from January 15, 1948.

In February, 1951, Schalk paid $20,000 to Union Bank & Trust Co. of Los Angeles for the account of Horace O. Smith, Jr., $17,364.38 to Hazel I. Farman, and $5,788.13 each to Patricia Baker and Evelyn Smith Marlow. Of such sums the amount of $2,364.38 paid to Hazel I. Farman and the amounts of $788.13 paid to Patricia Baker and Evelyn Smith Marlow, respectively, are claimed by Schalk to be interest at the rate of five per cent per annum from January 15, 1948.

On February 28, 1951, Horace O. Smith, Jr., and Schalk executed escrow instructions to Union Bank & Trust Co. of Los Angeles whereby Schalk deposited $20,000 to be paid to Horace O. Smith, Jr., when the Bank held for the benefit of Schalk, pursuant to Court order, the 16,666 shares which otherwise would have been distributed to Horace O. Smith, Jr.

On March 20, 1951, an order was entered in the Estate of Horace O. Smith, Deceased, Los Angeles Superior Court No. 100125, directing that there be distributed to Hazel I. Farman 50,000 shares, to

Evelyn Smith Marlow 16,667 shares, to Patricia Baker 16,667 shares and to Schalk 16,666 shares, of the stock of Schalk.

No formal dividends were declared or paid by Schalk in 1951.

The net profit or loss (before taxes) of Schalk for the years 1942 through 1951 was as follows:

Year	Net Profit or Loss (Before Taxes)
1942	$18,170.84
1943	63,280.34
1944	77,526.87
1945	46,867.94
1946	95,030.80
1947	(32,158.67)
1948	26,504.07
1949	5,252.45
1950	47,603.13*
1951	8,638.91

Post-1913 accumulated earnings and profits of Schalk as of December 31, 1950, totalled $67,861.31.

Petitioners Gerald I. Farman and Hazel I. Farman, and petitioners John Carver Baker and Patricia Baker omitted from their gross income for the year 1951 an amount properly includible therein in excess of 25 per centum of the amount of gross income reported in their returns.

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*Does not include the deductions of $45,000 and $3,697.92 which are at issue.

Opinion

Raum, Judge: Schalk accrued on its books and deducted in its return for 1950 the liability, which it assumed in the Assignment Agreement of December 29, 1950, to pay $45,000 to Hazel I. Farman, Patricia Baker, Evelyn Marlow and Horace O. Smith, Jr., and interest at 5 per cent per annum on $25,000 from January 15, 1948. The respondent disallowed the claimed deduction. Petitioners now concede that $20,000 of the $45,000 is not deductible by Schalk, but contend that the remaining $25,000 plus the interest is deductible by it as an ordinary and necessary business expense.

In support of their contention, petitioners argue that the settlement agreement was not a purchase and sale agreement although cast in the form of one; that therein, for $25,000, Smith agreed to resign as supervisor of the trust and as an officer and director of Schalk (and to obtain the resignation of the officers and directors whom he had caused to be elected or maintained in office); and, for $20,000, Smith granted to Hazel I. Farman, Patricia Baker and Evelyn Marlow (hereinafter referred to as the other beneficiaries) an option to purchase for $20,000 the stock interest in Schalk distributed to him upon termination of the trust. Assuming this construction of the agreement to be correct, they argue that the $25,000 payment made by the other beneficiaries to Smith at the time of the execution of the agreement was justified and necessary for the preservation of the business of

Schalk; that if Schalk had paid, or by resolution of its board of directors had authorized the payment of, the $25,000, this amount would have been deductible by Schalk; that, disregarding form, the substance of the transaction was that it was authorized by the "majority owners" (the other beneficiaries) on behalf of and for the benefit of Schalk, and, therefore, by Schalk; that Schalk was, therefore, morally obligated to reimburse the other beneficiaries for the $25,000 payment and for interest on the money they borrowed in order to make that payment; and that when it assumed the obligation to reimburse them it became entitled to deduct $25,000 and interest in the amount of $3,697.92.

After Smith became supervisor of the trust in 1943 the other beneficiaries, led by Gerald I. Farman, Smith's stepfather, became dissatisfied with the management and policies of Schalk. Suggestions made by them which they thought were in the best interests of Schalk were not followed by Smith and the officers and directors whom he had caused to be appointed. In April, 1947, Evelyn Smith Marlow and Patricia Baker filed a suit to have Smith removed as supervisor. Demurrers to the complaint were sustained, and during the period that the plaintiffs might have filed an amended complaint, representatives of Smith and the other beneficiaries entered into negotiations to settle the controversy. During these negotiations Smith offered to sell his interest in the trust and resign as supervisor of the trust and officer and director of Schalk. The other

beneficiaries suggested that Schalk purchase Smith's interest in the trust. Smith refused, and insisted that any settlement agreement had to be between Smith, as an individual, and the other beneficiaries, as individuals.

The parties to the settlement agreement were in fact the other beneficiaries and Smith. Schalk was not a party to, and did not authorize the other beneficiaries to enter into, the agreement. Petitioners' argument that the agreement was nevertheless informally authorized by Schalk and that it was, therefore, obligated in equity and good conscience to reimburse the other beneficiaries for the $25,000 payment made by them, is without merit. Their reasoning is that the other beneficiaries beneficially owned 83⅓ per cent of Schalk; that as "majority owners" they were acting on behalf of and solely for the benefit of Schalk and for the preservation of its business when they entered into the agreement; and that their action was in substance the action of Schalk. This reasoning overlooks the fact that the trust agreement, which created their beneficial interests, placed complete control of Schalk in Smith, the supervisor of the trust, and prevented them from acting for or on its behalf. Not having any power to act for Schalk, we fail to see how any action taken by them can be deemed to be the action of Schalk. Moreover, we think petitioners place undue stress on the benefits to Schalk from the settlement agreement and not enough on the benefits they were seeking for themselves. The other beneficiaries sought the resignation of Smith as su-

pervisor of the trust because they were dissatisfied with the management and policies of the corporation under his regime and wanted to acquire the right, which they did not have, to participate in its management and control. We are satisfied that they thought their participation would be beneficial to the corporation, but we are not convinced that the management of the corporation under Smith was incompetent and that their action was either necessary or desirable to preserve its business. If the anticipated benefit to the corporation materialized they would benefit personally therefrom as income beneficiaries of the trust whose principal asset was the stock of Schalk. In the circumstances we think it reasonable to assume that they were not overlooking that benefit and that their action in entering into the settlement agreement was motivated to some extent, if not entirely, by the benefits they thought would accrue to them personally. In any event, Schalk did not authorize them to act, formally or informally, and it was not obligated, morally or legally, to reimburse them for the $25,000 they paid pursuant to the terms of the settlement agreement. Its failure to do so distinguishes the facts here involved from those in cases such as Catholic News Publishing Co., 10 T.C. 73, cited by petitioners.

There being no obligation on the part of Schalk to reimburse the other beneficiaries for the $25,000 payment made by them in 1948, its action approximately three years later in agreeing to reimburse them for that payment together with the interest

they had paid on money they borrowed to make it, and for assuming their remaining obligations under the settlement agreement, did not, in our judgment, result in an ordinary or necessary business expense.

Moreover, we do not agree with petitioners that the consideration the other beneficiaries received for the $25,000 payment was the resignation of Smith as supervisor of the trust and as an officer and director of Schalk. Smith agreed to resign if the other beneficiaries would purchase his one-sixth minority interest in the stock of Schalk at the termination of the trust. Under the terms of the settlement agreement he received no cash consideration for his resignation. Therein the other beneficiaries agreed to pay him $45,000 for his stock interest, $25,000 of which was to be paid at the time of the execution of the agreement and the remaining $20,000 on or before thirty days after the termination of the trust. The provision relating to the $25,000 payment reads, in part, as follows:

> For and in consideration of the sum of $25,000.00 to First Party [Smith] in hand paid by Second Parties [the other beneficiaries] * * * First Party agrees to sell * * * and Second Parties * * * agree to buy * * * upon the termination and distribution of that certain trust dated December 29, 1930 * * * all of the then right, title and interest of the First Party in and to the corpus and any accumulations thereof then belonging or distributed to First Party. (Underscoring supplied.)

It is apparent from this provision of the agreement that $25,000 was the down payment the other beneficiaries obligated themselves to make (and made) at the time of the execution of the agreement in consideration for Smith's agreement to sell them his minority stock interest at the termination of the trust. If Schalk had made this payment in the first instance, it clearly would not have been entitled to deduct it as an ordinary and necessary business expense because it was part of the purchase price of an asset, particularly in the absence of a satisfactory showing that the purchase price was excessive. Its character was not changed by reason of the fact that Schalk assumed the obligation to reimburse, and did reimburse, the other beneficiaries for the payment made by them. Respondent did not err in determining that Schalk was not entitled to any ordinary and necessary expense deduction in 1950 when it voluntarily agreed to reimburse the other beneficiaries for the $25,000 payment, and for the interest they had paid on the money they had borrowed to make this payment.

Petitioners make the alternative contention that if the liability assumed by Schalk to reimburse the other beneficiaries for interest in the amount of $3,697.92 is not deductible as a business expense, then it is deductible as "interest." This amount is clearly not deductible as "interest" as there was no indebtedness on the part of Schalk on which interest could accrue.

Petitioners' next contention is that the respond-

ent erred in determining that the payment of $25,000 made by Schalk to the other beneficiaries in 1951 constituted a dividend to Hazel I. Farman and Patricia Baker in that year to the extent that they participated in the receipt of the payment.

The trust in which the other beneficiaries owned beneficial interests in the stock of Schalk terminated on December 29, 1950. On that date, for all practical purposes, Hazel I. Farman became the owner of 50,000 shares, Patricia Baker 16,667 shares, and Evelyn Smith Marlow 16,667 shares, although the order directing distribution was not entered until March 20, 1951. In February, 1951, Schalk made a distribution to them of $25,000. Hazel I. Farman received $15,000 of this amount and Patricia Baker and Evelyn Smith Marlow $5,000 each, which were the amounts each of them had paid to Smith at the time of the execution of the settlement agreement.

A dividend is defined in Section 115(a), Internal Revenue Code of 1939, as "any distribution made by a corporation to its stockholders * * * out of its earnings or profits * * *." A distribution of corporate earnings may constitute a dividend notwithstanding that the formalities of a dividend declaration are not observed, and that it is not in proportion to stockholdings. Paramount-Richards Theatres, Inc., v. Commissioner, 153 F. 2d 602, 604 (C.A. 5), affirming a Memorandum Opinion of this Court.

On December 31, 1950, Schalk had post-1913 accumulated earnings and profits substantially in ex-

cess of the $25,000 distributed in February, 1951, and the other beneficiaries who received that distribution were in full control of the corporation. It reimbursed them for the down payment they made and were obligated to make, pursuant to the terms of the settlement agreement, in consideration for Smith's agreement to sell them his minority interest in the stock of Schalk at the termination of the trust. As already noted, Schalk was not a party to the settlement agreement, did not authorize the payment, and was not obligated, legally or morally, to reimburse them therefor. Its action in reimbursing them for the payment was, therefore, voluntary, and in the absence of any evidence by petitioners that the amount distributed to them did not come from its accumulated earnings and profits, the distribution constituted a dividend as defined in Section 115(a), supra. Respondent did not err in his determination that the individual petitioners, to the extent that they participated in the distribution, received a dividend.

The third contention of petitioners is that the respondent erred in determining that the payment by Schalk of $20,000 in 1951 constituted a distribution essentially equivalent to a dividend to Hazel I. Farman and Patricia Baker to the extent that the corporation discharged a contractual obligation of these petitioners.

The respondent contends that Schalk in 1951 made a $20,000 distribution in redemption of the minority interest in its stock held by Smith, which

the other beneficiaries were contractually obligated to purchase under the terms of the settlement agreement, and that such a distribution is essentially the equivalent of a dividend to them since it operated to discharge their obligation.

Petitioners urge that the settlement agreement gave the other beneficiaries a mere option to purchase Smith's minority stock interest at the time of the termination of the trust, which they did not exercise; that they assigned the option to Schalk; and that the exercise of the option by Schalk did not benefit them directly or indirectly in any appreciable degree and did not discharge any obligation of theirs which would result in a distribution essentially equivalent to the receipt of a dividend. Petitioners cite Holsey v. Commissioner, 258 F. 2d 865 (C.A. 3), reversing 28 T.C. 962.

Petitioners rely on the paragraph of the settlement agreement which provides that if the other beneficiaries should "fail, neglect or refuse to pay the balance of the purchase price," $20,000, Smith would be released from any obligation to sell his one-sixth stock interest and the other beneficiaries "shall be released of any and all obligations to purchase" the same "or to pay * * * any additional moneys" to Smith.

This isolated provision of the settlement agreement merely restricts the remedy of Smith, in the event the other beneficiaries default and fail to pay the $20,000 balance of the purchase price, to the retention of the $25,000 down payment. Somewhat

similar provisions in other contracts have been held not to give the purchaser a mere option to purchase where other provisions thereof clearly indicate that it was the intention of the parties to enter into a binding contract for the purchase and sale of property. See Vance v. Roberts, 93 Fla. 379, 118 So. 205; Wright v. Suydam, 72 Wash. 587, 131 P. 239; and cf. Rodriguez v. Barnett, 333 P. 2d 407 (Cal. App. 1958). Here the settlement agreement provides that, "It is distinctly understood and agreed that First Party [Smith] agrees to sell and Second Parties [the other beneficiaries] agree to buy all of the assets of said Trust * * * distributed to First Party upon the termination of said trust * * *" and that the "First Party agrees to sell * * * and Second Parties jointly and severally agree to buy * * * all of the then right, title and interest of First Party in and to the corpus and accumulations * * * of the trust."

Our conclusion is that the other beneficiaries were obligated under the terms of the settlement agreement to purchase, and Smith to sell, Smith's minority interest in the stock of Schalk; that the purchase price was $45,000, $25,000 of which was payable at the time of the execution of the agreement and the remaining $20,000 when the trust terminated; and that the provision upon which petitioners rely did not convert the binding contract for the purchase and sale of Smith's interest into a mere option. When Schalk paid the $20,000 it satisfied a contractual obligation of the other beneficiaries, two of whom, Hazel I. Farman and Patricia

Baker, are petitioners in these proceedings. Had the other beneficiaries made the payment it would have cost them $20,000 and they would have become the owners of all of Schalk's outstanding stock. When Schalk assumed their obligation and paid $20,000 in redemption of the 16,666 shares of its stock held by Smith, the other beneficiaries became the owners of all of its outstanding stock without cost to themselves. When the transaction was concluded therefore the other beneficiaries were in substantially the same position they would have been in if Schalk had not assumed their obligation and had distributed to them $20,000 and they had used this money to satisfy their obligation to purchase the portion of Schalk's outstanding stock, owned by Smith, which they did not then own. In the circumstances we are convinced that the respondent did not err in his determination that the $20,000 payment by Schalk in 1951 constituted a distribution essentially equivalent to a dividend to Hazel I. Farman and Patricia Baker to the extent that Schalk discharged their contractual obligation, and we so hold. Wall v. United States, 164 F. 2d 462 (C.A. 4); Zipp v. Commissioner, 259 F. 2d 119 (C.A. 6), affirming 28 T.C. 314; Garden State Developers, Inc., 30 T.C. 135.

The remaining issue is whether the assessment of deficiencies, determined against petitioners Gerald I. Farman and Hazel I. Farman, and petitioners John Carver Baker and Patricia Baker for the year 1951, is barred by the statute of limitations. Deficiency notices were mailed to them within five

years, but not within three years, after their 1951 returns were filed. Assessment of the deficiencies is, therefore, barred under Section 275(c), Internal Revenue Code of 1939, if they did not omit from their gross income for 1951 an amount properly includible therein in excess of 25 per centum of the reported gross income. In view of our holding in respect of the dividend issue, simple arithmetic demonstrates that there was an omission of more than 25 per cent of gross income; accordingly, assessment of the deficiencies is not barred under Section 275(c).

Decisions will be entered for the respondent.

Filed July 9, 1959.

Served July 9, 1959.

The Tax Court of the United States,
Washington

Docket No. 63853

SCHALK CHEMICAL COMPANY, a California Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed July 9, 1959, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year 1950 in the amount of $15,087.22.

/s/ ARNOLD RAUM,
Judge.

Entered July 21, 1959.
Served July 22, 1959.

The Tax Court of the United States,
Washington

Docket No. 63855

GERALD I. FARMAN and HAZEL I. FARMAN,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed July 9, 1959, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year 1951 in the amount of $11,589.98.

/s/ ARNOLD RAUM,
Judge.

Entered July 21, 1959.
Served July 22, 1959.

The Tax Court of the United States,
Washington

Docket No. 63862

JOHN CARVER BAKER and PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, filed July 9, 1959, it is

Ordered and Decided: That there is a deficiency in income tax for the taxable year 1951 in the amount of $2,465.86.

/s/ ARNOLD RAUM,
Judge.

Entered July 21, 1959.

Served July 22, 1959.

In the United States Court of Appeals
for the Ninth Circuit

Tax Court Dockets Nos. 63853, 63855 and 63862

SCHALK CHEMICAL COMPANY, a California Corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

GERALD I. FARMAN and HAZEL I. FARMAN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

JOHN CARVER BAKER and PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF DECISIONS OF THE TAX COURT OF THE UNITED STATES

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

Schalk Chemical Company, a California corporation, Gerald I. Farman and Hazel I. Farman, and

John Carver Baker and Patricia Baker, and each of them, through their attorney of record, respectfully petition the United States Court of Appeals for the Ninth Circuit to review the decisions of The Tax Court of the United States entered in the above cases on July 21, 1959, pursuant to its findings of fact and opinion filed July 9, 1959 (32 T.C. No. 76), ordering and deciding:

"That [in the case of Schalk Chemical Company] there is a deficiency in income tax for the taxable year 1950 in the amount of $15,087.22."

"That [in the case of Gerald I. Farman and Hazel I. Farman] there is a deficiency in income tax for the taxable year 1951 in the amount of $11,589.98."

"That [in the case of John Carver Baker and Patricia Baker] there is a deficiency in income tax for the taxable year 1951 in the amount of $2,465.86."

The cases were consolidated in the Tax Court for the purposes of trial and opinion.

This petition for review is taken and filed pursuant to the provisions of Sections 7482 and 7483 and other applicable sections of the Internal Revenue Code of 1954, as amended.

Nature of Controversy

The asserted tax liabilities which are involved in these cases stem principally from:

(1) Respondent's and the Tax Court's disallowance of Schalk Chemical Company's deduction, as an ordinary and necessary business expense, of a liability which it assumed to reimburse amounts which its present shareholders borrowed and paid to a former minority shareholder, who at the time owned a one-sixth beneficial interest in the stock of the Company but who by reason of the terms of a spendthrift trust the principal asset of which consisted of all the stock of the Company had absolute control of the Company and power to vote all its stock. The money was paid, petitioners contend, on behalf of the Company and for its benefit and the preservation and protection of its business and reputation to free the Company from domination by the particular individual, in circumstances which would have led persons of ordinary prudence to act in similar fashion. The Company could not act in any respect except as the minority shareholder might permit. For personal reasons he refused to allow the Company to make or authorize the payments to himself. The individual petitioners in good faith acted to protect the Company in the only way that it was possible for them to act.

(2) Respondent's and the Tax Court's determination that such reimbursements constituted distributions essentially equivalent to dividends to the individual petitioners.

(3) Respondent's and the Tax Court's determination that the subsequent redemption of the minority shareholder's one-sixth stock interest re-

sulted in constructive dividends to the individual petitioners.

Petitioners respectfully urge that the Tax Court's rulings on these and other issues are contrary to law and are not supported by the evidence. Particularly in regard to (3) above, the Tax Court, in petitioners' opinion, erroneously interprets the settlement agreement under which Schalk Chemical Company was relieved of absolute domination and control by the minority shareholder as obligating the individual petitioners to purchase his one-sixth stock interest upon subsequent termination and distribution of the assets of the trust from which his extraordinary powers over the Company flowed.

The distinctive feature of these cases is that for a period of twenty years, from December, 1930, to December, 1950, the outstanding stock of Schalk Chemical Company was the principal asset of a spendthrift trust. The beneficiaries were of one family.

Under the terms and designations in the trust instrument entered into when the children were minors, a son having a one-sixth beneficial interest in the trust eventually (in 1943) succeeded to the office of "Supervisor" of the trust with the extraordinary right to exercise by himself absolute power and control over the management and policies of the Company. He excluded the other members of the family including his mother (their beneficial interests under the trust aggregating 83⅓%) from any voice in the management of the Company and

over a period of several years dominated the Company following a policy of preservation of the status quo and of nonexpansion and nondevelopment of products which the other members of the family believed was adverse to the best interests of the Company and was endangering its future, especially in view of the fact that the Company's specialty field had become highly competitive in the post-war years.

In 1947 the Company suffered a substantial operating loss and its working capital became seriously depleted. Fearing that the Company would fail or would be wasted to an extent from which it could not recover before the trust terminated and the son lost the power and control which he had by virtue of the trust, the other members of the family in January, 1948, finally succeeded in securing his resignation as "Supervisor" of the trust and as president and director of the Company and the resignations of the directors and officers which he had appointed.

It is this settlement, the later assumption by the Company of the amounts paid in connection therewith and the redemption of the son's one-sixth distributive stock interest on termination of the trust which give rise to the questions presented on this review.

Court in Which Review Is Sought

The United States Court of Appeals for the Ninth Circuit is the Court in which review of the above

decisions of The Tax Court of the United States is sought pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954, as amended.

Venue

Schalk Chemical Company is a corporation organized and operating under the laws of the State of California. Its Federal income tax return for the taxable year 1950 was filed with the Collector (now District Director) of Internal Revenue for the Sixth District of California, in which collection district taxpayer's principal office and place of business was (and now is) located.

Gerald I. Farman and Hazel I. Farman are husband and wife. Their joint Federal income tax return for the taxable year 1951 was filed with the Collector (now District Director) of Internal Revenue for the Sixth District of California, in which collection district taxpayers were (and now are) residing.

In 1951 John Carver Baker and Patricia Baker were husband and wife. Their joint Federal income tax return for the taxable year 1951 was filed with the Collector (now District Director) of Internal Revenue for the Sixth District of California, in which collection district taxpayers were (and now are) residing.

The office of the Collector (now District Director) of Internal Revenue for the Sixth District of California to which the foregoing returns were made

in respect of which the alleged additional tax liabilities of the respective petitioners arise was (and now is) located at Los Angeles, California, within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought.

The parties have not stipulated that the decisions of the Tax Court herein referred to may be reviewed by any other United States Court of Appeals.

Wherefore, it is respectfully requested that the decisions and related findings of fact and opinion of the Tax Court of the United States herein referred to be reviewed by the United States Court of Appeals for the Ninth Circuit.

/s/ DONALD KEITH HALL,
Attorney for Petitioners.

Received and filed October 19, 1959, T.C.U.S.

[Title of Court of Appeals and Cause.]

Tax Court Dockets Nos. 63853, 63855 and 63862

NOTICE OF FILING PETITION FOR REVIEW

To: Hart H. Spiegel, Esquire, Chief Counsel, Internal Revenue Service, Washington, D. C.

You Are Hereby Notified that the above-named petitioners on October 15, 1959, duly mailed to the

Clerk of The Tax Court of the United States, at Washington, D. C., for filing, a petition for review by the United States Court of Appeals for the Ninth Circuit of the decisions of the Tax Court heretofore rendered in the above-entitled cases.

A copy of the petition for review as mailed for filing is hereto attached and served on you.

October 15, 1959.

/s/ DONALD KEITH HALL,
Attorney for Petitioners.

Affidavit of Service by Mail attached.

Received and filed October 19, 1959, T.C.U.S.

The Tax Court of the United States

Dockets Nos. 63853, 63855, 63862

In the Matter of:

SCHALK CHEMICAL COMPANY, et al.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

TRANSCRIPT OF PROCEEDINGS

Wednesday, July 16, 1958

The above-entitled matter came on for hearing pursuant to notice, at 10:00 o'clock a.m.

Before: The Honorable Arnold Raum.

Appearances:

MR. DONALD KEITH HALL,
Appearing for Petitioners.

MR. MARION MALONE, and
MR. J. EARL GARDNER,
Appearing for Respondent.

The Clerk: Dockets Nos. 63853, 63855, 63862, Schalk Chemical Company, and related Petitioners.

Mr. Hall: Ready for Petitioners, your Honor.

The Court: State your appearances.

Mr. Hall: For Petitioner Donald Keith Hall.

Mr. Malone: For the Respondent, Marion Malone and J. Earl Gardner.

The Court: Have these cases been consolidated?

Mr. Malone: Your Honor, we expect to move that the cases be consolidated.

Mr. Hall: I have no objection, your Honor.

The Court: You wish to make that motion now?

Mr. Malone: I wish to make the motion that they be consolidated for trial, as well as for brief.

Mr. Hall: That is agreeable with Petitioners.

The Court: The motion will be granted. And I will treat the stipulation of facts which has already been filed as applicable to all three cases, as consolidated.

Mr. Hall: Yes, your Honor.

The Court: There is attached to the stipulation exhibits.

Mr. Hall: I will identify——

The Court: From 1 through 5, and also A through C. Proceed.

Mr. Hall: Your Honor, at this time I would like to identify for the record, if it is the proper procedure, Mr. May [3*] suggested that the exhibits be identified for the record in connection with the stipulation, and I would like to offer them at this time in evidence.

The Court: They are already in evidence as a result of the stipulation, stipulations having been filed. [4]

* * *

Mr. Hall: Your Honor, I have three documents which Government Counsel has reviewed and I believe we have agreed that they may be admitted without any foundation.

And I will designate them and show them to Counsel then, and then I will offer them.

The first is escrow instructions, dated February 28, 1959, of Union Bank and Trust Company of Los Angeles.

The second document——

The Court: Do you offer that one now? [36]

* * *

At this time, your Honor, I offer the escrow instructions that I have just described.

The Court: Admitted.

The Clerk: Petitioners' Exhibit No. 6.

***Page numbering appearing at top of page of original Reporter's Transcript of Record.**

(The document above referred to was marked Petitioner's Exhibit No. 6 and was received in evidence.)

Mr. Hall: The next document is 14 and final report and account current of trustee petition for approval and allowance of fees of trustee, and for final distribution of trust estate.

Mr. Gardner: No objection.

The Court: Admitted. [37]

Mr. Hall: I offer this as Petitioner's Exhibit No. 7.

(The document above referred to was marked Petitioner's Exhibit No. 7 for identification, and was received in evidence.)

Mr. Hall: Final document is order settling final account and report of trustee and for fees in the superior court of the State of California, and for the County of Los Angeles.

Mr. Gardner: No objection.

The Court: Admitted.

The Clerk: Petitioner's Exhibit No. 8.

(The document above referred to was marked Petitioner's Exhibit No. 8 for identification, and was received in evidence.)

Mr. Hall: I call Mr. Brinton.

CHARLES BRINTON

a witness called by and in behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and your address, please.

The Witness: Charles Brinton, B-r-i-n-t-o-n.

My address is 3680 Fair Meade Road, Pasadena.

The Clerk: California?

The Witness: Yes.

The Clerk: Thank you. [38]

Direct Examination

By Mr. Hall:

Q. Mr. Brinton, what is your profession?

A. I am a certified public accountant.

Q. Are you acquainted with Schalk Chemical Company? A. I am.

Q. When did you first become acquainted with Schalk Chemical Company? A. In early 1947.

Q. What was the nature of your contact with the company, at that time?

A. As an employee of Henry Rausch, certified public accountant, I conducted the audit of Schalk Chemical Company as of December 31, 1946.

Q. Did you do the same thing as to the account of Schalk Chemical Company for the year 1947?

A. I conducted the audit of Schalk Chemical Company for 1947; however, at that time I was a partner, rather than an employee of Mr. Rush.

Mr. Hall: May I ask that this document be marked Petitioner's Exhibit 9 for identification?

(Testimony of Charles Brinton.)

The Clerk: Petitioner's Exhibit No. 9 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 9 for [39] identification.)

Q. (By Mr. Hall): Mr. Brinton, I hand you a document which has been marked Petitioner's Exhibit 9 for identification; do you recognize that document? A. I do.

Q. What is it?

A. It is the audit report of Schalk Chemical Company for the year ended December 31, 1947.

Mr. Hall: I offer this document in evidence as Petitioner's Exhibit No. 9, your Honor.

Mr. Malone: Respondent objects to the admission of this document in evidence on the ground that it is not related to any of the years involved in this action; it is irrelevant and immaterial.

Mr. Hall: Your Honor, it is relevant on this position of the company, at the time of the settlement, which took place on January 15, 1948.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 9 was received in evidence.)

Mr. Hall: Would you please mark that as Petitioner's Exhibit No. 10 for identification.

The Clerk: Petitioner's Exhibit 10 marked for identification. [40]

(Testimony of Charles Brinton.)

(The document above referred to was marked Petitioner's Exhibit No. 10 for identification.)

Q. (By Mr. Hall): Mr. Brinton, I hand you a document which has been marked Exhibit 10 for identification; do you recognize that document?

A. Yes; I do.

Q. What is it?

A. This is a summary of gross sales and net profit or loss before taxes for the years 1937 through 1947, for Schalk Chemical Company.

Q. Did you assist me in the preparation of Exhibit 10 for identification? A. I did.

Q. From what source were the figures obtained which are shown on Exhibit 10 for identification?

A. These figures came from the audit report for the respective years.

Mr. Hall: I have given Counsel for the Government a copy of it, and I offer this document in evidence as Exhibit 10.

Mr. Malone: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 10 was received in evidence.) [41]

Mr. Hall: Please mark this as Exhibit 11 for identification.

The Clerk: Petitioner's Exhibit No. 11 marked for identification.

(Testimony of Charles Brinton.)

(The document above referred to was marked Petitioner's Exhibit No. 11 for identification.)

Q. (By Mr. Hall): Mr. Brinton, I hand you document marked Petitioner's Exhibit 11 for identification; do you recognize that document?

A. I do.

Q. What is it?

A. This is a statement of the profit or loss for each month during the year 1947, of Schalk Chemical Company, together with a figure for the profit or loss from January 1 to the end of each month during that same year.

Q. Did you assist me in the preparation of Exhibit 11 for identification? A. I did.

Q. From what source were the figures obtained which are shown on Exhibit 11 for identification?

A. These figures were obtained from profit and loss statements prepared by the company's accountant at the end of each month during 1947. [42]

Q. What was Schalk Chemical Company practice at that time, and what is it now, with regard to company prepared financial statements?

A. At the end of each month the accountant would prepare a balance sheet, a statement of profit and loss for the year to date, and a statement of profit and loss for the month just ended. These records have been prepared from the books of the general ledger of Schalk Chemical Company.

Mr. Hall: I offer that document, your Honor, as

(Testimony of Charles Brinton.)

Petitioner's Exhibit 11 for identification, as Petitioner's Exhibit 11.

Mr. Malone: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 11, was received in evidence.)

Q. By Mr. Hall): Mr. Brinton, there is a footnote on Exhibit 11; would you state the effect of the adjustment that is there described on the net result of operations in the month of April, 1947?

A. Yes. In the month of April, 1947, an entry was made setting up an account prepaid advertising, which represents a deferred expense. By reason of this entry [43] having been made in the month of April, the profit as reflected by this statement has been increased by $22,000 as a result of this entry.

Q. In other words, without the adjustment there would have been a loss in the month of April, 1947?

A. That is correct.

Mr. Hall: Mr. Clerk, would you mark this document as Petitioner's Exhibit 12 for identification as Petitioner's Exhibit 12 for identification?

The Clerk: Petitioner's Exhibit 12 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 12 for identification.)

(Testimony of Charles Brinton.)

Q. (By Mr. Hall): Mr. Brinton, I hand you a document marked Petitioner's Exhibit No. 12 for identification; do you recognize that document?

A. I do.

Q. What is it?

A. This is a statement reflecting the inventory of January 1, the purchases during the year, and the inventory as of December 31 for Schalk Chemical Company, for the years 1942 through 1947.

Q. Did you assist me in the preparation of [44] Exhibit No. 12 for identification? A. I did.

Q. From what source were the figures obtained which are shown on Exhibit 12 for identification?

A. These figures were obtained from the audit reports for the respective years.

Mr. Hall: I offer this document as Petitioner's Exhibit 12.

Mr. Malone: Respondent would like to ask whether the audit reports from which these are taken are available in the courtroom?

Mr. Hall: In answer to Mr. Malone's question, the audit reports are here, and I might state for the Court's benefit, that Government Counsel reviewed all of the audit reports for 1937 to '57, before we came to court.

The Court: Are they in the courtroom now?

Mr. Hall: Yes; they are. I have them, your Honor.

Mr. Malone: No objection to the document.

The Court: Admitted.

(Testimony of Charles Brinton.)

(The document heretofore marked for identification as Petitioner's Exhibit No. 12 was received in evidence.)

Q. (By Mr. Hall): Now, Mr. Brinton, have you computed the ratio of Schalk's cost of goods sold to gross sales in 1940, [45] based on the audit report of Schalk Chemical Company for that year?

A. Yes; I did.

Q. What was the ratio in 1940?

A. In 1940 the ratio of cost of goods sold to gross sales was 34 per cent.

Q. Based on Schalk's 1947 audit report, which is Exhibit, Petitioner's Exhibit 9 in evidence, what was the comparable ratio in 1947?

A. In 1947 the ratio of cost of goods sold to gross sales was somewhat in excess of—it was approximately 44.4 per cent.

Mr. Hall: You may examine.

Cross-Examination

By Mr. Malone:

Q. Mr. Brinton, you first became employed with Schalk in 1947; is that correct?

A. With——

Q. Schalk Chemical Company.

A. I was retained—well, my employer was retained in 1947, yes. That is, he was retained prior years, as well, but my first association was in 1947.

Q. And your association entitled you to the examination of all the books and records for Schalk?

(Testimony of Charles Brinton.)

A. Yes. [46]

Q. For 1947. Did you ever have occasion to look into the records of the company for prior years?

A. Yes.

Q. Did you look into the audit reports that were made by Henry Rausch for the years from 1942 through 1947, did you ever have occasion to look at those? A. I have.

Mr. Malone: Your Honor, the Respondent would like to offer for its next in order for identification a document purportedly an audit report of the Schalk Chemical Company for the year ended December 31, 1942.

The Clerk: Respondent's Exhibit D marked for identification.

(The document above referred to was marked Respondent's Exhibit D for identification.)

Mr. Hall: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked for identification as Respondent's Exhibit D was received in evidence.)

Q. (By Mr. Malone): Mr. Brinton, I hand you this Respondent's Exhibit D for identification.

The Court: That is in evidence now.

Mr. Malone: I offered it, your Honor, for identification. [47]

The Court: Well, when Petitioner's Counsel indicated no objection, I assumed that it was then

(Testimony of Charles Brinton.)

being offered in evidence, and I admitted it. However, if you do not wish it offered, I will order it stricken.

Mr. Malone: I do not care to have it offered at this time, your Honor.

The Court: All right. The Reporter will then indicate that Exhibit D for identification is not in evidence.

(Respondent's Exhibit D, previously admitted in evidence, was withdrawn.)

Q. (By Mr. Malone): Mr. Brinton, will you examine this document; will you state to the Court whether you have ever seen it before?

A. Yes; I have seen this statement before.

Q. Will you look at Exhibit A, to this document, and state what you see as the total current assets for the year ending December 31, 1942?

Mr. Hall: Your Honor, I object to the question on the ground that it is not proper cross-examination. I don't believe the year '42, except as to the ending figures on the profit and loss statement, were gone into on direct, nor—and also, the inventory and purchases.

But if we are going to go into, if it is the Government's position that it is material to go into [48] the whole financial statement in each of these years, I am willing to offer all of the audit reports for this period, and they can make the argument they wish from it.

This witness stated that he was not acquainted

(Testimony of Charles Brinton.)

with Schalk prior to the year 1947, and if we are getting to specific questions about specific accounts, and so forth, this witness is not qualified to answer it.

Mr. Malone: Your Honor, the witness has stated on cross that he had occasion to examine the books and records of the company prior to the time of his employment, and the question directed to him is merely a preliminary statement, asking him to repeat information which he can receive by looking at the document.

The Court: Do you plan ultimately to offer Exhibit D in evidence?

Mr. Malone: Yes, your Honor.

The Court: Since there has been no objection to it, and since this witness probably cannot add any more than what appears in the document itself, I suggest that you offer it, unless you think you can get some kind of illuminating testimony from the witness, other than reading from the document, what appears there.

Mr. Malone: Well, your Honor, there is considerable amount of material in this document, and the testimony that the Respondent wished to bring out is comparative statements as to certain of the facts which appear in the [49] document so that it would be of convenience to the Court, not to have to bother of looking at the entire, through all the figures and entries that are made on that record.

Mr. Hall: Your Honor, I make the offer at this time for the benefit of Government Counsel, that

(Testimony of Charles Brinton.)

I will take this stack of audit reports and we can number each separately, and we will introduce them and they can make whatever argument that he wants from the face of the audit reports, and I believe that is all that Counsel is going to do, and he attempts, when he attempts this examination of Mr. Brinton.

The Court: I assume Government Counsel could make up schedules similar to what appear in such matters as Exhibits 10, 11 and 12, which the Petitioner presented.

Mr. Hall: Which I did simply.

The Court: And that such schedules could be made up from the audit reports.

Mr. Malone: Well, if Respondent may have leave to submit such schedules, we have no objection, or would like to offer these documents into evidence now. All of those for the years 1942 through 1946, I believe Petitioner has offered document, the audit report for the year 1947 into evidence.

The Court: You now offer the audit reports from 1942 through 1946? [50]

Mr. Malone: Yes, your Honor.

The Court: They will be received and the Clerk will give them identifying symbols.

Mr. Hall: Pardon, your Honor, I didn't hear.

(Record read.)

Mr. Malone: Respondent offers five documents individually, the audit reports for Schalk Chemi-

(Testimony of Charles Brinton.)

cal Company, first of which is for the year ended December 31, 1942. Respondent offers this in evidence.

The second audit report is for the year ended December 31, 1943, which Respondent offers into evidence.

The Clerk: The first one will be Respondent's Exhibit D; the second one is Respondent's Exhibit E.

(The documents above referred to were marked Respondent's Exhibits D and E for identification.)

Mr. Malone: Respondent offers the audit for, audit report for Schalk Chemical Company for the year ended December 31, 1944, in evidence.

The Clerk: Respondent's Exhibit F.

(The document above referred to was marked Respondent's Exhibit F for identification.)

Mr. Malone: Respondent offers audit for the year ended December 31, 1945, for the year ended December 31, 1946, they are all in evidence. [51]

The Clerk: Respondent's Exhibits G and H.

(The documents above referred to were marked Respondent's Exhibits G and H for identification.)

(The documents heretofore marked for identification as Respondent's Exhibits D, E, F, G and H were received in evidence.)

Mr. Malone: Your Honor, the Respondent will stipulate that any pencil markings appearing on these original documents may be disregarded as not material to the information that is contained therein.

Mr. Hall: We will so stipulate that they shall be disregarded. Is that acceptable?

Mr. Malone: Yes.

* * *

(Witness excused.)

Mr. Hall: I will call Mr. Althouse.

JACK ALTHOUSE

a witness called by and in behalf of the Petitioner herein, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: My name is Jack Althouse, A-l-t-h-o-u-s-e. My address is 1700 Highland Oak Drive, Arcadia, California. [52]

The Clerk: Thank you.

Direct Examination

By Mr. Hall:

Q. What is your occupation, Mr. Althouse?

A. I am assistant to the president of Schalk Chemical Company.

Q. For how long have you been employed by Schalk Chemical Company?

A. For ten years, on March 16, 1958, I believe, it was.

(Testimony of Jack Althouse.)

Q. What are your duties as assistant to the president of Schalk Chemical Company?

A. As assistant to the president, and under his supervision, I have administrative control of the company. My responsibilities include all management functions.

Q. What, in general, is the nature of Schalk Chemical Company's business?

A. Schalk Chemical Company manufactures and distributes nationally a line of associated paint products and home repair products.

Q. What type of outlets in general are there for Schalk's products?

A. Primarily paint stores, hardware stores, department stores and chain stores.

Q. How many offices and plants does Schalk have? [53] A. We have two.

Q. Where are they located?

A. One in Los Angeles, California, and one in Chicago, Illinois.

Q. How long have those plants existed?

A. The present plant in Chicago, I think Schalk moved into that one in '46, but Schalk has had an eastern office since the early 1920's.

Q. And the Los Angeles office?

A. There has been a Los Angeles office since the inception of the company, the corporation, in 1903.

Q. Now, what is the function of the Los Angeles office and plant?

A. The Los Angeles office is the main office of

(Testimony of Jack Althouse.)

the Schalk Chemical Company. It carries on the credit procedures, bookkeeping records and so forth.

In addition, it manufactures products, invoices them and services the United States from a north-south line through Denver on west.

Q. What functions are performed in the Chicago office and plant?

A. The Chicago office and plant manufactures products, invoices and services accounts from a north-south line from Denver east.

Q. Is most of Schalk Chemical's manufacturing done [54] in Los Angeles or Chicago?

A. Considerably more of it is done in Chicago.

Q. What ratio is done in Chicago, as compared to Los Angeles?

A. About 80 per cent is done in Chicago, about 20 per cent here in Los Angeles.

Q. Now, referring specifically——

Mr. Gardner: Might I inquire as to what year or years that we are talking about; is that the present business set-up, or was this the business set-up when you took over, or in 1950?

A. For the past ten years at least, a rough ratio of sales between east and west has been about 80 per cent Chicago, 20 per cent West Coast.

Mr. Hall: Thank you, Mr. Gardner.

Q. (By Mr. Hall): Referring specifically to the commencement of the year 1948, what products were then being produced and marketed by Schalk?

A. You would like the names of them?

(Testimony of Jack Althouse.)

Q. Yes. A. Prior to 1948?

Q. Well, at the beginning of the year 1948, what were they producing and marketing?

A. They were producing Hydro Pura, [55] Savabrush, Double X, Waxoff, Crack Filler, Wood Putty, Plaster Pencil and Spot Remover.

Q. That is a total of how many products?

A. That is a total of eight products, and they were available in 16 sizes.

Q. There were 16 assorted sizes?

A. Of the eight products; yes, sir.

Q. As to each of those products that you have named, when was each put on the market for the first time by Schalk?

A. Hydro Pura, 1903; Savabrush, 1920; Double X, 1924; Waxoff, 1932; Crack Filler, 1937; Wood Putty, 1940; Plaster Pencil in 1946, and Spot Remover in 1947.

Q. Now, does Schalk today produce those products? A. Yes.

Q. Have any changes been made in those products since the beginning of 1948?

A. Yes; several changes have been made.

Q. What changes have been made, Mr. Althouse, in general?

A. Several formula changes to improve the products, make them more saleable and several packaging changes.

Q. Several package——

A. Packaging changes, varying colors, varying sizes, that sort of thing. [56]

(Testimony of Jack Althouse.)

Q. How many products in total does Schalk produce and market today?

A. Schalk has 17 products today, in 41 assorted sizes.

Q. In other words, nine products as I understand it, have been added to the Schalk line since the beginning of the year 1948?

A. That is correct.

Q. Would you state chronologically the years in which each of those nine products have been added to the Schalk line?

A. Tile Cement was added in 1948; Patch Paste in 1950; Tile Paste in 1952; Liquid Savabrush in 1953; Liquid Waxoff in 1954; 1956 we added three products, Surex Paint Remover, X-It Paint Remover, and Do-X; 1957 S-14 Spackling Compound.

Q. From your experience with Schalk, how long does it take customarily to develop and market a new product of the type produced by Schalk?

A. From the time we present the idea, to a chemist, and go on through the art work, package design, formula, and so forth, approximately a year, until the product is actually on the market.

Mr. Gardner I didn't get the time.

The Witness: Approximately one year. [57]

Mr. Gardner: Thank you, sir.

The Witness: Yes.

Mr. Hall: I have a document to be marked as Petitioner's Exhibit 13 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 13 for identification.)

(Testimony of Jack Althouse.)

Q. (By Mr. Hall): Mr. Althouse, I hand you a document which I will refer to as Petitioner's Exhibit 13 for identification, and ask you if you recognize that document? A. Yes, I do.

Q. What is it?

A. This is a copy of the Schalk Chemical Company dealer's price list for the year 1947, latter part of the year of 1947.

Q. Was that taken from the books and records of Schalk Chemical? A. Yes, sir, it is.

Mr. Gardner: May I ask a question regarding this document?

Does this document purport to contain all of the products manufactured by Schalk at this time?

The Witness: With one exception, these are paint and hardware items. One product, Hydro Pura has been, for [58] many years, a grocery store item, and it is therefore not listed on that price list.

Mr. Gardner: Now, as I understand it, this contains all of the products that they have at this time?

The Witness: In 1947.

Mr. Gardner: In 1947?

The Witness: Yes, sir, with the exception of Hydro Pura.

Mr. Gardner: With the exception of Hydro Pura?

The Witness: Yes.

Mr. Hall: That document is dated November 1, 1947, Mr. Gardner.

(Testimony of Jack Althouse.)

I offer this as Petitioner's Exhibit 13.

The Court: Admitted.

Mr. Gardner: No objection.

(The document heretofore marked for identification as Petitioner's Exhibit No. 13 was received in evidence.)

Mr. Hall: Mr. Clerk, will you mark that as Petitioner's Exhibit 14 for identification?

The Clerk: Petitioner's Exhibit 14 marked for identification.

(The document above referred to was marked Petitioner's Exhibit No. 14 for identification.) [59]

Q. (By Mr. Hall): Mr. Althouse, I hand you a document which has been marked Petitioner's Exhibit 14 for identification, and ask you if you recognize that document? A. I do.

Q. What is it?

A. This is the dealer's price list of Schalk Chemical Company for the year 1958.

Mr. Gardner: If the Court please, I would object to the introduction of this on the basis that this is much too remote to connect with any of the issues in this case. We are concerned here with 1950, 1951, not 1958.

Mr. Hall: Your Honor, much of the material that we have gone up to this point, is preliminary to further testimony, and Mr. Althouse has testified

(Testimony of Jack Althouse.)

as to when each of these products was introduced by Schalk.

And to complete the picture, I offer this as preliminary to later discussion of the problems they had as to products and so forth.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 14 was received in evidence.)

Mr. Hall: Just to clarify, your Honor, what Mr. Gardner asked about—— [60]

Q. (By Mr. Hall): Mr. Althouse, neither Exhibit 13 nor Exhibit 14 lists or pictures Hydro Pura. Would you explain why that is?

A. All of the products listed on both the 1947 dealer price list and the 1958 dealer's price list are the associated paint products, and the home repair products that we have talked about earlier. They are sold through the paint stores, the hardware stores, department stores and chain stores.

Hydro Pura, on the other hand, has been for many years a grocery store item, and not sold by our own salesmen, but by grocery brokers.

The Court: What is Hydro Pura?

The Witness: It is a wall cleaner, similar, to compete with Spick and Span, Soilax, and that type of product.

Q. (By Mr. Hall): Years ago it was?

A. Years ago it was a water softner when it first came on the market.

(Testimony of Jack Althouse.)

Q. Now, Mr. Althouse, referring to Exhibit 13, which was the prior exhibit, price list, and to the prices that are shown on that exhibit, for how many years have those prices been in effect prior to November 1, 1947, [61] which is the date that shows on that exhibit?

Mr. Gardner: If the Court please, I don't think this is the proper witness to get that information from. He was not even with the company until 1948.

Mr. Hall: But, Mr. Gardner, it is available from the records of the company, and this gentleman has full management control of the company, as assistant to the president.

The Court: The witness may answer.

The Witness: The prices for the products in the respective sizes as they are indicated on the sheet, had never been changed from the particular year in which each product was introduced to the market.

In other words, there is no particular year for, like, say that it would cover the whole thing; because Double X, from '24 for instance, Waxoff from '32, Crack Filler from '37, Wood Putty from '40, Plaster Pencil from '46, Spot Remover from '47.

Q. (By Mr. Hall): So that the prices shown on Exhibit 13 were the prices set at the time?

A. At which they were introduced.

Q. At the time the product was put on the market; is that correct? A. Yes. [62]

Q. Subsequent to the date of Exhibit 13, were those prices changed at any time?

A. Yes, they were.

(Testimony of Jack Althouse.)

Q. When were the prices first increased?

A. The prices were first increased in February of 1948.

Q. And what was the nature of the increase; I don't mean to go through each item, but approximately what was it?

A. The prices were raised on all products except Savabrush and Double X. They were raised approximately 20 percent.

Q. Have there been any subsequent price increases? A. Yes.

Q. When were they?

A. There was an additional price increase in August and September of 1951. There was an additional increase in January of 1956, and there was another increase in January of 1957.

In each case, the increase was not necessarily across the board, but it approximated ten percent, 10 to 12 percent.

Q. Now, at the time of the—at the date of Petitioner's Exhibit 13, which is November 1, 1957, what trade discounts were allowed by Schalk Chemical Company? [63]

A. The Schalk trade discount was 33⅓ percent, and 25 percent, which is a complete net discount of 50 percent.

Q. How did that discount compare with discounts allowed by other companies or competitors in this particular field?

A. It was less discount than competitive products.

(Testimony of Jack Althouse.)

Q. Now, subsequent to the year 1948, has Schalk made any changes in the trade discounts under which it allows? A. Yes, we have.

Q. What changes have been made?

A. The trade discount was increased from the 33⅓ and 25 percent, to 40 percent and 25 percent, which gives a net complete discount of 55 percent.

Q. Now, what is Schalk Chemical Company's practice with respect to accounting for the amount of sales contributed each year by each of its products?

A. Each month we tabulate the case sales on each product for that month, on each size of each product for that month. By the same token, and at the same time, we also tabulate the dollar sales for the month period.

Then at the end of any given period, at the end of a year, for instance, it is a simple matter to multiply the number of cases sold of each size of each product, times the net billing price for that product, and arrive at what [64] percentage of the total that was accounted for by the particular product.

Q. Was such a tabulation made for the year 1957? A. It was.

Q. With respect to the nine products which you testified have been added to the Schalk line since the beginning of the year 1948, what part of the gross sales of Schalk in 1957 were generated by those nine products?

A. From a dollar standpoint, the nine products

(Testimony of Jack Althouse.)

added since 1948 accounted for $407,159.46 of the 1950 sales—1957 sales, pardon me, of $476,627.45.

This means that the nine products added since '48 accounted for 53.2 percent of the 1957 sales volume.

Mr. Hall: You may examine.

Cross-Examination

By Mr. Gardner:

Q. Mr. Althouse, I believe you testified that you were, have been an assistant to the president of Schalk for approximately ten years?

A. No, no, sir, I did not.

Q. What did you state, sir?

A. I have been an employee of Schalk since 1948. I have been assistant to the president, I believe, since 1954.

Q. 1954? [65] A. Yes, sir.

Q. What were your duties when you were first employed by Schalk?

A. I started with Schalk as a salesman.

Q. As a salesman? A. Yes, sir.

Q. And that was in the year 1948; is that correct, sir? A. Yes, sir.

Q. And who employed you?

A. I believe I was hired by Mr. Herman.

Q. Mr. Herman? A. Yes, sir.

Q. Did you know Mr. Farman prior to the time you were employed?

(Testimony of Jack Althouse.)

A. I had met Mr. Farman, I believe, on just one occasion prior to my employment.

Q. I see. Did you know Mrs. Farman?

A. I had met Mrs. Farman on one occasion prior to my employment.

Q. Did you know either of the daughters, that is Patricia or Evelyn?

A. I knew neither of them.

Q. You knew neither? A. No. [66]

Q. You are not related in any way?

A. No.

Q. To the Farmans, or—— A. No, sir.

Q. Now, the paint products that were manufactured by the company prior to 1948, I believe you stated—was that correct, sir? A. Yes, sir.

Q. You are still manufacturing those products, I take it; is that correct?

A. Yes, that is correct.

Q. And I believe you stated that it takes one year to prepare a product for market; is that right? A. Yes, I did say so.

Q. What process do you go through in determining whether or not a product will be acceptable, whether or not you should manufacture a product?

A. Well, most of our ideas for products come from the trade, itself, from our own salesmen, or from our basic suppliers who are always looking for ways and means of distributing their basic products and selling them.

Once the idea has been more or less proved out through talking to the trade, and finding out what

(Testimony of Jack Althouse.)

competition is, and so forth, then it is turned over to our chemists who start working with these various supplies of basic [67] materials on a formula. Once the formula has been tentatively approved, then it is normally marketed.

A paint item, for instance, we might have the painters in a given area, or in several areas, try the product and give us their opinions. Many times from this type of work we find that the product is in need of some improving, and we go back to the laboratory.

Once we think we have the product all set to go, then it is a question of arriving at a package design, art work for the package, cataloging pages, trade advertising, consumer advertising, and actually getting the product on the market.

Q. Do you use any research agency to determine whether or not the sale of this item will be successful? A. A research agency as such, no.

Q. You do your own research in that respect?

A. Yes, we do; that is right.

Q. I take it—— A. That is right.

Q. Is there such a research agency available?

A. Oh, yes, there are several.

Q. Several?

A. There are several agencies available; very expensive, however.

Q. Let me ask you, sir, you stated that you did [68] develop nine products during the period of '48 to '57, which were successful; now, did you develop any products which were not successful?

(Testimony of Jack Althouse.)

A. If from develop you mean did any products actually go onto the market, that were not successful, that answer would be no.

Q. Now, prior to putting them on the market, you have sort of a little test that you make, you send the product around to the ultimate user, or something, is that what you do?

A. Well, that could be one form, yes. We might do some sampling with our various accounts, but more likely we would have a sales test in a limited area to see what the market acceptance was.

Q. Did you have any failures resulting from the disappointment in the sales test?

A. No, I don't believe we did.

Q. In other words, you were 100 percent successful in everything you did from '48 to '58; is that right?

A. Well, success, Mr. Gardner, is a relative thing. Some of the products we did much better on than we did on others. I think in every case we set a certain goal for the product. We surely don't reach that goal in every instance.

Q. But in any event, during this period of time [69] you had no products that you sought to sell that is, you got so far as making test of sales that were not successful; is that right?

A. We had no products that we withdrew from the market because sales fell below a break-even point.

Q. Now, at what point did you withdraw, or did you ever have any products that you worked on

(Testimony of Jack Althouse.)

that you had to discard; could you tell me about that?

A. The only product per se, no, we had one size of one product that because of the nature of the product wasn't successful in a tube, and it was necessary that we withdraw the tube size of the product from the market. The product, itself, is still very much on the market.

Q. I see. There was no product as such that you looked into with the idea of putting it on the market that you did not carry through and eventually put on the market, constituting one of these nine?

A. Mr. Gardner, I haven't said that, sir. We often have ideas of our own, or from our salesmen for products that we turn over to the lab, and as a matter of fact, we have innumerable products right now that are still in the lab and have never been brought out for one reason or another.

What I have attempted to say is that any product that has a period on the market during the years we have [70] been talking about is still on the market, and the sales are still, warrant its staying on the market.

Q. I see. I am trying to determine just how much experimentation you did in order to come up with nine saleable items.

Now, these are not the only items that you experimented on, are they? A. No, my, no.

Q. You spend considerable time on others?

A. By all means.

Q. You are not always successful, are you?

(Testimony of Jack Althouse.)

A. By all means not.

The Court: I think you testified that some of the, that some 50 percent or 53 percent of the sales in 1957 were attributable to the so-called new products?

The Witness: Yes, sir, I did.

The Court: Now, some of those new products were simply the old products in different form, were they not?

The Witness: No, sir, that wouldn't be true. Some of the new products bore names of the old products, because of the fact that the years had been in our favor, in establishing these products with the trade.

However, I assume you are referring to liquid Savabrush, for instance, as opposed to powder Savabrush.

The Court: Did liquid Savabrush in your judgment, to [71] any extent supplant sales that you might otherwise have had of the powdered Savabrush?

The Witness: To a great extent, yes.

The Court: It did supplant it?

The Witness: It is an entirely different market, your Honor, and——

The Court: If liquid Savabrush had not been available, would you have had greater sales of the powdered Savabrush?

The Witness: We would have had less sales of powdered Savabrush.

(Testimony of Jack Althouse.)

The Court: You mean less than you in fact had of the powdered Savabrush?

The Witness: Yes, yes.

Mr. Gardner: There is just one thing——

The Court: It is an interesting statement; I would be glad to have your explanation.

The Witness: All right, I will try to give it.

Mr. Hall: I was going to ask that, your Honor.

The Witness: Yes, I will try to give it.

There are many accounts in the country, chain store accounts for instance, with the Grant, Firestone, J. J. Newberry, also many large paint and hardware accounts, who for one reason or another did not previously handle the Schalk line; Savabrush, for instance, up until a few years ago was a ten cent item, and many of these stores— [72] you can imagine the amount of volume to have a ten cent item in order to end up with any sales volume at the end of the year.

When, however, Schalk Chemical came out with items like liquid Savabrush with a higher list value, many of these accounts took on the Schalk line as such, and in so taking on the line carried with the old products like Savabrush and Waxoff.

Q. (By Mr. Gardner): At the same time weren't you attempting to get into the hardware stores more and more, too; don't you have a sales force out?

A. By all means, Mr. Gardner; yes, sir.

Q. Don't they contact these hardware stores?

A. Yes, sir.

(Testimony of Jack Althouse.)

Q. Isn't it a gradual process of contact and contact and then eventually getting the account; doesn't that have something to do with it?

A. Yes, sir.

Q. I mean, your salesmen, themselves?

A. Yes, sir.

Q. Weren't you putting on more and more effort through these years to get more accounts?

A. More than, more effort than what, Mr. Gardner?

Q. Don't you have a continual, make a continual [73] effort to get more accounts?

A. By all means, yes, sir. We make a continual effort to better our salesmen, better train them, and——

Q. How large was your sales force in 1948, sir? A. I don't recall, Mr. Gardner.

Q. How large was your sales force now?

A. We have approximately 15 salesmen.

Q. Fifteen salesmen. The figures that you quoted I noticed you obtained those figures from some sort of memorandum in your pocket?

A. Yes, sir.

Q. Who prepared that memorandum?

A. The memorandum that I have was prepared by me, Mr. Gardner.

Q. That was prepared by you. Are you an accountant, sir? A. No, I am not.

Q. Where did you get the figures that you put on that memorandum?

(Testimony of Jack Althouse.)

A. Those figures came off the case sales report for the year 1957.

Q. What is a case sales report?

A. It is a breakdown of all cases sold during the year of each individual size of each individual product.

Q. And who added them up? [74]

A. That was done by our bookkeeper in the office.

Q. That was done by somebody else?

A. Yes.

Q. And is there any possibility that you could have made an error in your figures?

A. These figures, Mr. Gardner, can be reconciled, and have been by the total of each individual size of each individual product in relation to the total sales for the years, period.

Q. But you haven't done that, have you?

A. No, sir; I haven't done that.

Q. You just took the figures that were given you, and you can't say whether or not they are accurate, can you? A. I guess not, sir.

Mr. Gardner: No further questions.

Redirect Examination

By Mr. Hall:

Q. The products that were produced by Schalk Chemical Company prior to 1948, Mr. Althouse, were any of those in liquid form?

A. No. [75]

* * *

(Testimony of Jack Althouse.)

The Court: You may proceed.

Mr. Hall: Your Honor, may I recall Mr. Althouse for a couple of questions on redirect examination? Government Counsel has no objection.

The Court: You may.

Mr. Hall: Mr. Althouse.

JACK ALTHOUSE

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

Redirect Examination

(Continued)

By Mr. Hall:

Q. Mr. Althouse, from 1949 to 1954 what position did you hold in Schalk Chemical Company?

A. I was manager, eastern division.

Q. By manager, what do you mean?

A. I was responsible administratively for all the activities of the Chicago factory, plant and sales operation.

Q. That office covered what territory nationally?

A. That covers the eastern United States from roughly the north and south line through Denver, Colorado.

Q. Mr. Althouse, yesterday you testified that or concerning a case sales summary which Schalk makes monthly, semi-annually and annually.

Do you have with you summaries of that nature?

A. Yes; I did. [78]

Q. What years, Mr. Althouse?

(Testimony of Jack Althouse.)

A. These are the semi-annual and annual summaries from 1954 up through the first six months of 1958.

Q. What is the purpose of making a sales summary?

A. It served two purposes really.

One, it provides one of the checks and balances in making sure that errors don't occur in sales figures.

Two, it's really the only accurate comparison we have on sales for a given product, a given size of a given product, for a given period of time. I say it's the only accurate record we have. Dollar totals can be misleading by reason of the fact that if you have a price increase, for instance, your billing on a particular product would automatically be higher, and if you considered only the dollar value, you might imagine that you have a modest increase in sales for this particular product when it's not only conceivable but likely that you might have a decrease or sales might be static.

Q. I see.

Thank you, Mr. Althouse.

Recross-Examination

By Mr. Gardner:

Q. By the way, Mr. Althouse, how old are you?

A. I'm 39.

Q. You are 39, and ten years ago you were 29, is [79] that correct? A. That's right.

(Testimony of Jack Althouse.)

Q. Twenty-nine at the time you were assistant manager?

A. I was made manager, eastern division, in 1949. I guess I would be 30 years old.

Mr. Gardner: Thank you, sir.

Redirect Examination
(Continued)

By Mr. Hall:

Q. What was your formal education, Mr. Althouse?

A. I have a Bachelor of Science Degree in Business Administration.

Mr. Hall: Thank you.

Mr. Gardner: No further questions.

Mr. Hall: May this witness be excused?

The Court: He may be excused.

(Witness excused.)

Mr. Hall: Call Mr. Farman.

GERALD I. FARMAN

a witness called by and in behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: You may be seated, please.

Will you state your name and address for the record, please? [80]

The Witness: G. I. Farman, F-a-r-m-a-n, 205 W. Orange Grove Avenue, Sierra Madre.

(Testimony of Gerald I. Farman.)

Direct Examination

By Mr. Hall:

Q. Mr. Farman, are you president of Schalk Chemical? A. I am.

Q. Are you also one of the individual Petitioners in this proceeding? A. I am.

Q. Will you speak up, Mr. Farman, for the purpose of the Reporter? A. I will.

Q. How long have you been president of the Schalk Chemical Company?

A. Since January 15, 1948.

Q. Mrs. Farman is also an individual Petitioner in this proceeding, is that correct?

A. That is correct.

Q. When were you and Mrs. Farman married?

A. August 14, 1931.

Q. Approximately how old was Mrs. Farman's son, Mr. Horace O. Smith, Jr., at that time?

A. I believe about 17.

Q. Did Mr. Smith live with you and Mrs. Farman after your marriage? [81] A. Yes.

Q. For how long after?

A. Until he got married.

Q. You recall when that was?

A. No; I do not. I don't recall the date.

Q. After Mr. Smith's marriage, where did he and his wife live?

A. They lived in the guest house that was adjoining up.

Q. In other words, they lived with you?

(Testimony of Gerald I. Farman.)

A. On the property, yes.

Q. For how long did they live with you, approximately?

A. Approximately two years, I would say.

Q. Mr. Farman, what formal education did Mr. Smith have?

A. He, as I recall it, he went through grade school, public school, and then he went to private, went in a private school. He didn't graduate from high school. He went in a private school.

Q. Mr. Farman, do you know when Mr. Smith started to work for Schalk Chemical Company?

A. As I remember, it was 1936. I haven't that date.

Q. Prior to going to work for Schalk Chemical Company, what business experience did Mr. Smith have, if any? [82]

A. He worked for a Ford agency in Pasadena for approximately six months, as a salesman.

Q. Did he have any other prior business experience? A. Not to my knowledge.

Q. As far as you know?

A. Not to my knowledge.

Q. During the years 1940 to 1945, Mr. Farman, what was your occupation?

A. I was a chief of supply of the Pacific Division, Army Engineers, U. S. Army.

Q. What were your duties as chief of supply?

A. The awarding of contracts, the contracts for building the airports, the ordnance bases, all work that is done by the Army Engineers in connection

(Testimony of Gerald I. Farman.)

with war effort, various types of camps, directing dredging of harbors for the Navy. It does not answer it?

Q. You refer to the Pacific Division. What was the Pacific Division?

A. The Pacific Division included the 11 western states, the south Pacific, central Pacific, and north Pacific theaters of operation.

Q. Mr. Farman, while you were acting in that capacity as chief of supply for the Corps of Engineers, did you have at any time, have any occasion to contact Schalk on the behalf of the Corps of Engineers? [83]

A. It was my duty to obtain supplies from various sources of various types of supplies; on two different occasions that I specifically recall at this moment I wanted to purchase double X for bleaching hospital floors at Modesto and was turned down.

I tried through Mr. Smith direct and later through Mrs. Farman to get these supplies, explaining that I would issue a priority for the raw material.

On another occasion I wanted a water softener for Marysville. And Marysville is built on the lava bed there, and the water is very, very hard, and I wanted hydro pura for water softener and offered them a large order with a priority, and I was turned down. That order was later given to Borax, and I asked Borax to contact Schalk because they had automatic packaging equipment and, get them to

(Testimony of Gerald I. Farman.)

take over as a subcontractor, so that I could get this supply expedited.

Q. As to each of those, I want to ask you some questions, Mr. Farman.

You mentioned an order for Double X. When, approximately, was that?

A. As I recall, it was 1943.

Q. Who did you talk to and talk about it?

A. And I talked to Mr. Lieben and Mr. Smith directly about it. [84]

Q. Who was Mr. Lieben?

A. Mr. Lieben was the manager at that time of this office here, I believe.

Q. You also mentioned Hydropura, an order for Hydropura. When was that, Mr. Farman?

A. I don't recall the exact date. It was either 1942 or '43, I believe, that we billed Marysville.

Q. Who did you talk to on that occasion?

A. Mr. Smith and Mr. Lieben.

Q. Did you personally talk to anybody at Schalk about packaging material for Borax?

A. Yes; I went with Mrs. Farman down to the office and asked. Mrs. Farman said why can't we package this, this Borax material for them, and I was present when it was turned down again. [85]

* * *

Q. (By Mr. Hall): Were there any other occasions on which you contacted Schalk for materials for use in some war effort with which you were connected?

(Testimony of Gerald I. Farman.)

A. During 1942 and 1943 and 1944 we were building crash boats over at San Quentin, and one other place in McNeil Island in the northwest, and we wanted a caulking material for these crash boats and I tried to buy wood putty from Schalk for this.

I believe, as a matter of record, I did write to Schalk: I have not a copy of this, incidentally; I wrote to Schalk and asked to buy 10,000 pounds of wood putty for caulking; San Quentin was turned down.

Q. Mr. Farman, as chief of supply for the Pacific Division of the Corps of Engineers, what was your authority with respect to the issuance of priorities?

A. I had full authority to issue a priority on every, on all supplies and every project that was built where the contractor supplied the materials.

Q. Were the priorities issued by your office?

A. They were issued by my office.

Q. As I understand your testimony, these orders that [86] you testified to were refused by Schalk?

A. They were.

Q. What did Mr. Smith say to you with regard to these orders, if anything?

A. I recall Mr. Lieben's answer much more clearly, that if we supplied the Government with the supplies, why, they may not, it may interfere with their customer relations.

In fact, they thought their customers should supply the Government direct at a profit, which I ob-

(Testimony of Gerald I. Farman.)

jected to. I complained to Mr. Lieben at that time again that I would issue a priority for the supplies, and it was our general practice to issue approximately ten per cent overage, and he would have the benefit of that ten per cent in raw materials for customer relations, again our customer accounts.

Q. Mr. Farman, as chief of supply and concerning these orders, were those the only orders which you could have directed to Schalk at that time?

A. Absolutely not.

I happened to be in a position that we were using various types of materials that Schalk was making and especially in camouflaging oil storage plants and down the coast. The aircraft factories were all camouflaged under our offices, and we needed materials for cleaning our spray guns and other materials that Schalk were manufacturing, in dire need of them. [87]

Q. Mr. Farman, was this attitude on the part of the management of Schalk a matter of concern to you and Mrs. Farman and the rest of the family?

A. It surely was, very much.

Q. Did it become a matter of controversy between you? A. It did.

Q. Then in the period from 1942 to '45 what other policies or actions of Schalk's management, if any, caused you and Mrs. Farman and the rest of the family to become concerned about the business?

A. Well, Mr. Smith would not co-operate in any

(Testimony of Gerald I. Farman.)

way with the other stockholders of Schalk. He wouldn't take advice.

During that period—I don't want to get off from the subject here—during that period there was a terrific demand from the trade, meaning retailers and wholesalers alike, for any product they could possibly get ahold of to sell.

Prior to 1940 obviously Schalk's products had reached a peak and had started sliding due to the fact that they were outmoded.

We suggested that it was imperative that the company go into a research program and develop new products that were easier to use and not so commonly known in formula [88] wise, and so forth.

Any product development and research of the markets were turned down.

I can't recall offhand all of the various things that came up exactly.

We did, Mrs. Farman presented, and in my presence, and I presented new products, and they were turned down, completely, by management, including Mr. Lieben and Mr. Smith.

One of the products specifically was liquid starch. It had never been a liquid starch on the market, and we came in with a formula for liquid starch.

Mr. Gardner: May I interrupt just a moment, please?

The witness is continually referring to "we." I would like to have that clarified as to who he means by this term.

(Testimony of Gerald I. Farman.)

The Witness: In this instance Mrs. Farman and I. I will use that from now on.

Mr. Gardner: And on the prior instances that we made suggestions which were received?

The Witness: That is, I will clarify that by saying Mrs. Marlow; that is Mr. Smith's sister. Mrs. Baker, Mrs. Smith's sister, a stockholder, and Mrs. Farman and myself. I will be very clear.

Mr. Gardner: Thank you.

The Witness: DDT was another product that we thought was new, it was new, and on the market we thought, Mrs. Farman [8] and I specifically, mentioned this as an insecticide, it wasn't on the market.

Mr. Gardner: May I inquire again, sir, what year are we speaking about?

The Witness: We are speaking of the years from 1942 to 1945.

Mr. Gardner: 1942 to 1945 you suggested DDT?

The Witness: That is a question.

Q. (By Mr. Hall): Mr. Farman, what production methods were used by Schalk in those years?

A. The first time I saw the factory in Chicago was in October or September or October, 1945. They were filling packages by hand, using a little scope, graduated scope, filling it, gluing the packages and putting them in a container to hold.

Q. Did they have any automatic equipment?

A. They had no automatic equipment. They had some or one piece of semi-automatic equipment.

Q. Did you recommend to management that they

(Testimony of Gerald I. Farman.)

install automatic equipment? A. I did.

Q. During that period was the advertising of Schalk handled through any agency?

A. It was handled through during the period of 1942 [90] to 1945, I believe it was Honig-Cooper. It was handled through Dr. Hal Stephens, who was vice president of Erwin Wasey Company, and then that was absorbed by Honig-Cooper. I can't tell you the exact date, but it was all handled by their same agency.

Q. Were you and Mrs. Farman satisfied with the particular advertising picture of Schalk?

A. We definitely were not.

That was again a main point of controversy because of the money spent on advertising without any follow up.

Q. What advertising does Schalk employ?

A. At this time?

Q. What did it employ at that time?

A. They used full pages in the Saturday Evening Post, full pages in Better Homes and Gardens, American Home, Good Housekeeping, and many other leading magazines.

Q. Your objection, then, was that the costs were out of line?

A. The costs were prohibitive.

Q. You mentioned Mr. Lieben being manager. Was the fact that Mr. Lieben was manager a matter of controversy?

A. Very much so. Mr. Lieben was the dominating influence in the Schalk Company. Mr. Lieben's at-

(Testimony of Gerald I. Farman.)

titude towards Mrs. Farman was not timely. [91]

Mr. Gardner: If the Court please, I would like to object to the testimony of this witness insofar as it relates to Mrs. Farman and the other members of the family. It hasn't been shown there have been any foundation here that this witness is associated with the corporation at this time. Now anything he has to state regarding the members of the family is strictly hearsay, and I object very strongly to any testimony by this witness relating to how the members of the family felt or any testimony in connection with that at all.

What he felt, that's all right, but there has been no foundation to show that he was connected either with this corporation at this time.

The Court: He may state what he observed.

Mr. Hall: In his presence.

The Court: In his presence, but he may not——

The Witness: I'll definitely state that Mr. Lieben was very insulting to Mrs. Farman in my presence and caused the family to be very concerned over his position as manager, and later when he was promoted to general manager of the company.

Further, I was told by Mr. Fulmer, the manager in Chicago——

Mr. Gardner: I object to this now. This is something that is hearsay that is coming in here. [92]

The Witness: Hearsay when it's told me direct?

Mr. Gardner: Let's not have him testify to it, I think then.

(Testimony of Gerald I. Farman.)

The Court: The witness may not say what someone else told him.

Mr. Hall: Your Honor, at a time as Mr. Gardner states that there has been no foundation that he was connected with the corporation, or would that ruling apply to after the time he was connected with the corporation?

The Court: I haven't made any such general ruling.

My ruling is simply limited to hearsay statements.

I suggest it might be more helpful if Counsel put direct questions to the witness rather than letting him wander at large.

Mr. Hall: Thank you.

Mr. Gardner: Could we also have dates? I never get the date, the time Mrs. Farman was insulted by Mr. Lieben in his presence. I don't know whether that was prior to the period we're talking to or subsequent.

Q. (By Mr. Hall): When did that occur, Mr. Farman? A. In 1945 and 1946.

Q. When did you leave the position as chief of supply of the Corps of Engineers?

A. In August, 1945. I took annual leave. [93]

Q. The war had ended by that time; was that the reason you left that job?

A. It was the reason that I took annual leave, that my work had slacked down and I had not had a day off from August, 1940.

(Testimony of Gerald I. Farman.)

Q. What did you immediately do upon taking annual leave?

A. I talked with Bob and Mrs. Farman.

The Court: Who is Bob?

The Witness: Pardon me. Mr. Smith. I'm sorry. I talked with Mrs. Farman and Mr. Smith in regard to their problems. They were the various problems that had been in controversy.

Q. (By Mr. Hall): When did that conversation take place?

A. In the latter part of August and the 1st of September, 1955.

I made certain suggestions.

Q. Just a minute. Do you know a Mr. Henry O. Wackerbarth? A. I do.

Q. Who is Mr. Wackerbarth?

A. An attorney here in Los Angeles.

Q. What connection did he have with Schalk Chemical Company? [94]

A. He was a secretary and a director for the company and the attorney for the company.

Q. At what period of time, Mr. Farman?

A. From 1931 through 1947.

Q. When were you elected a director of Schalk Chemical, if you recall.

It has been stipulated, your Honor, that it was in 1945.

Mr. Gardner: I believe that was it.

Q. (By Mr. Hall): Do you know, Mr. Wackerbarth's signature? A. I do.

Q. Would you be able to recognize it?

(Testimony of Gerald I. Farman.)

A. Yes; I would.

Mr. Hall: Mr. Clerk, will you mark this Petitioner's Exhibit 15 for identification, please?

The Clerk: Exhibit 15 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 15 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you a document which has been marked Petitioner's Exhibit 15 for identification, and I ask if that document bears the signature of Mr. Wackerbarth? [95]

A. It does.

Q. Will you describe what that document is?

A. Well, it mentioned——

Q. No, no, Mr. Farman. I just wanted you——

A. It's a letter addressed to Mr. Stanley Guthrie, Mrs. Farman's attorney.

Q. What is the date of it, Mr. Farman?

A. Dated September 20, 1945, in which it sets forth the various controversies.

Q. That is enough. And was Mr. Wackerbarth Mr. Smith's attorney? A. He was.

Q. Mr. Farman, Petitioner's Exhibit 15 for identification is addressed to Mr. Stanley W. Guthrie. Who was Mr. Guthrie?

A. Mr. Guthrie was Mrs. Farman's attorney.

Mr. Hall: I offer this as Petitioner's Exhibit 15.

Mr. Gardner: No objection.

The Court: Admitted.

The Clerk: Petitioner's Exhibit 15.

(Testimony of Gerald I. Farman.)

(The document heretofore marked for identification as Petitioner's Exhibit No. 15 was received in evidence.)

Mr. Hall: Your Honor, may I place that in front of the witness for a moment? [96]

Q. (By Mr. Hall): Mr. Farman, Petitioner's Exhibit 15 refers to an arrangement involving the setting up of an executive committee for the company.

Was such a committee set up?

A. It was.

Q. How was it accomplished?

A. The bylaws of the corporation were amended to allow for an executive committee.

Q. At the time the bylaws were amended to set up the executive committee, were there any changes made in the directors of the company?

A. I was made a director at that time.

Q. Anyone else that you recall?

A. Mr. Guthrie was accepted with a position of director.

Q. Were you elected an officer at that time?

A. I was not.

Q. Were you later elected an officer?

A. Later in 1946 I was elected a vice president.

Q. Did the executive committee prove to be a satisfactory arrangement?

A. It did not. It was completely ignored by Mr. Smith, and it was not a workable plan.

(Testimony of Gerald I. Farman.)

Q. Why wasn't it workable? [97]

A. Because Mr. Smith didn't recognize the executive committee. It was only a name. It was a name only and he did not recognize it.

Q. What vote was required of the members?

A. Unanimous vote on all subjects of any consequence, all major subjects, at least.

Q. Who were the members appointed to the executive committee?

A. Mrs. Farman, Mr. Smith and myself.

Q. How long did Mr. Guthrie stay on the board of directors?

A. Approximately a year, to my knowledge. I wouldn't say a year.

Q. Did he resign at that time?

A. He was asked by Mr. Smith to resign.

Q. In what year was this?

A. In 1947.

Q. I believe it was in 1946, was it not?

A. It could have been. I'm sorry.

Q. He was asked by Mr. Smith to resign?

A. He was.

Q. Mr. Guthrie had accepted the privilege of being the director on what condition?

A. On one condition only, that he would go in as an arbitrator. [98]

Q. At a subsequent time after his resignation as director or was that vacancy filled?

A. It was filled by Mr. Smith, filled by a Mr. Roush.

Q. Who was Mr. Roush?

(Testimony of Gerald I. Farman.)

A. Mr. Roush was the auditor for the firm at that time.

Q. Do you recall when Mr. Roush was elected a director?

A. He was elected a director, I believe, in March, 1947, when I was fired.

Q. Was there an annual shareholders' meeting in 1947? A. There was.

Q. Do you recall approximately the time that that meeting was?

A. I believe it was either January or February. I can't recall the exact date.

Q. It was at that meeting that Mr. Roush was elected director?

A. That was the meeting when he was elected.

Q. Was there an annual directors' meeting following the annual stockholders' meeting?

A. There was, yes.

Q. What took place at that meeting, Mr. Farman?

A. The office of vice president was the office that I held, as vice president was, no—— [99]

Q. Was what?

A. Well, it was eliminated. I guess that is the term for that. The executive committee was dispensed with, and the bylaws amended to take care of both the office of vice president and the executive committee.

Q. By take care, what do you mean?

A. To abolish these two positions.

Q. Were you present at that meeting?

(Testimony of Gerald I. Farman.)

A. I was.

Q. Did you object to that action?

A. I did.

Q. Did Mrs. Farman object? A. She did.

Q. But you remained a director, is that correct?

A. I was director because I represented my two, the two girls, Mrs. Marlow and Mrs. Baker.

Q. By represented, what do you mean, Mr. Farman?

A. Well, I was their representative on the board of directors for the company, at their request. Mr. Smith and his board couldn't eliminate that position because of my representing them.

Q. Was that because of the provisions of the trust?

A. That's because of the provision for the trust, of the trust.

Q. Now, as I understand it, approximately December, [100] 1945, until early in 1947 you were employed by Schalk Chemical? A. I was.

Q. During that period of employment, what were your duties with Schalk Chemical?

A. I was an expediter of raw materials from September, '45, until all through that period.

Also, in 1946, entered into the study and means of recommendations on modern production, buying equipment, and that sort of thing.

Q. And now what was your first job that you undertook for Schalk?

A. I understood to get materials for Schalk.

Q. What did you do in that regard first?

(Testimony of Gerald I. Farman.)

A. I went to Chicago with Mr. Smith and found that——

Q. When was that?

A. That was in September, 1945.

Q. What were the conditions at the Chicago plant at that time?

A. They were entirely out of materials. The employees were not doing anything because of not having any raw materials to formulate and package.

Q. What did you do by going to Chicago?

A. I immediately took all of the orders that were, they had on hand, which was a tremendous amount of orders, [101] and advised them to find out, ascertain how much materials would be needed to fill these back orders that dated back as far as June, 1945.

After making the analysis, I then had a quick picture of the amount of materials that would be required to operate the business.

Q. Was management taking any action at that time to secure materials?

A. Their version to me was they couldn't get them.

Q. Were you behind—strike that.

Were you hired in a sense to obtain materials; that was the purpose of your being?

A. That was the purpose of my employment.

Q. What items were they short of exactly, Mr. Farman?

A. They were out of trisodium phosphate, which

(Testimony of Gerald I. Farman.)

was the bulk of their raw material requirements. They were entirely out of sodium perborate, another product that was essential to the formulation of the products.

In fact, they were entirely out of all materials that were required.

Q. Trisodium phosphate, would you explain which of the products that were then produced by Schalk, which of those products was it essential to have trisodium phosphate for?

A. Their leading product and the largest profits maker [102] is Double X, and it's essential to Double X, also essential to Savabrush and Waxoff.

Q. The other item was what, that you specifically mentioned?

A. Sodium Perborate I specifically mentioned, which is very essential to Double X. There were two other products.

Q. The company was also manufacturing wood putty at that time? A. Wood putty.

Q. What is the essential ingredient in wood putty?

A. Molding plaster, which is a gypsum product, was essential and it was in short supply.

Q. At the time you reviewed the orders, did you ascertain from whom Schalk Chemical was obtaining these two, let's say, two essential raw materials?

A. I did.

Q. Who were they obtaining those from?

A. They were obtaining trisodium phosphate—

(Testimony of Gerald I. Farman.)

that's misstated—they had a contract with General Chemical for trisodium phosphate.

They were not getting any supply at all on that contract. They had a contract with DuPont Corporation for perborate, and perborate was essentially, it was on priority and was so important to the war effort they were unable to obtain that, and they had a contract with United [103] States Gypsum Company for molding plaster, which was not being recognized by U. S. Gypsum.

Q. After you reviewed the orders and determined what was needed, what did you do?

A. I asked permission to go to New York to see General Chemical Company, and also I wanted to be at New York to see the American Agricultural Company, which is a big manufacturer of trisodium phosphate and so forth.

Q. Did you go to New York?

A. I went to New York and contacted these people.

Q. Did you contact U. S. Gypsum?

A. I did.

Q. Did you contact General Chemical?

A. I did.

Q. Did you obtain any supplies from them?

A. From neither one of them.

Q. Were you able to obtain supplies?

A. I was able to obtain supplies, yes.

Q. Approximately when were you able to arrange to have these raw materials shipped to Schalk?

(Testimony of Gerald I. Farman.)

A. I have two carloads of trisodium phosphate rolling from an independent source in October, 1945, and November, 1945.

Q. Did you set up any general sources of supply for those raw materials other than from United States Gypsum or [104] general chemical?

A. I set up a new source of supply right in Joliet, Illinois, known as the Lawson Chemical Company, who agreed to supply us trisodium phosphate, supply all our needs of trisodium phosphate, though it was in short supply.

Q. Do you obtain that raw material from them, that organization today? A. We do.

Q. What about molding plaster?

A. I went to a new source of supply, the Circle T Corporation, and obtained their willingness to supply us our full requirement of molding plaster, and they fulfilled that promise.

Q. How soon after you embarked upon this job of obtaining materials did the plant in Chicago go back to full production?

A. To my best recollection, we were back in full production in February, 1946.

Q. In addition to raw materials, were there any other essential supplies that were short?

A. Very difficult to obtain shipping cases, the cartons, the packages that we packaged in. Any paper products were in short supply, and I had to find sources for that.

Q. Was Schalk in short supply itself? [105]

(Testimony of Gerald I. Farman.)

A. Definitely out of most of all shipping cases, most cartons.

Q. Were you able to obtain those supplies for Schalk?

A. I was. In fact, I obtained a carload of cartons in Chicago and shipped them to Los Angeles for their production.

* * *

Q. (By Mr. Hall): Now, Mr. Farman, did you have anything to do with the development of new products for Schalk Chemical Company in 1946?

A. I obtained the two products and recommended their——

Q. You were looking into the subject of the product of Schalk Chemical Company at that time?

A. Mrs. Farman and I recommended approximately 18 or 20 products that would fit into Schalk Chemical Company. Some of them——

Q. The products that were then being manufactured by Schalk were what, Mr. Farman? [106]

A. Were Savabrush, Double X, Waxoff, Wood Putty and Crack Filler.

Q. In your opinion were those products meeting the market demand at that time?

A. Market study that I personally made in 1945 in Southern California indicated that the products were fast becoming obsolete.

Q. Why was that, Mr. Farman?

A. Because new products were being introduced to the market that were easier to use, faster and more effective in the form of liquid products.

(Testimony of Gerald I. Farman.)

Q. Were all of the products that were then being produced in powdered form, is that correct?

A. All products in 1945 were produced in powdered form.

Q. Was there a product added to the line in 1946?

A. Plaster Pencil was added in 1946.

Q. What did you have to do with adding that product to Schalk Chemical line?

A. I was in Boston working with Mr. White, Edmund White, one of Schalk's salesmen at that time, and we called on a customer over in Cambridge, and I found a plaster stick called plaster stick, made by the Leonard Company in Des Moines, Iowa, and bought one of them and discussed possibility of Schalk's going into that and another product [107] and eventually we did produce that product.

Q. That, you mentioned that product to management? A. I did.

Q. What was management's reaction?

A. They were reluctant to go into it, I believe, for at least one reason.

They couldn't manufacture it themselves. They didn't have the facilities.

Q. Was it manufactured by Schalk when it was put on the market?

A. It was not. It was manufactured by the Lake Chemical Company of Chicago.

Q. Was that pursuant to a contract between Schalk and the Lake Company?

(Testimony of Gerald I. Farman.)

A. We contracted with them to make this product.

Q. Who arranged that contract?

A. I did personally.

Q. Were there any products added to the Schalk line in 1947?

A. During 1946 I also found another product on the market for cleaning grease off from wall paper, and I think—I picked up that package and recommended that we also go into that product.

It was produced, actually got onto the market in 1947. [108]

Q. You stated that some other products were recommended but refused, Mr. Farman. Would you give some illustrations?

A. We recommended a liquid brush cleaner.

Mr. Gardner: If the Court please, once again I would like to have the witness instructed to state who is this we.

The Witness: I'm sorry.

These recommendations that I will mention were made by Mrs. Farman and Mrs. Marlow, some by Mrs. Marlow, some by Mrs. Baker, and some by myself. I cannot segregate them.

We recommended a liquid brush cleaner which was very essential because liquid brush cleaners were coming on the market and powder brush cleaners were commonly, are fast becoming flow movers.

Q. (By Mr. Hall): Were there any on the market at that time, Mr. Farman?

(Testimony of Gerald I. Farman.)

A. Liquid brush cleaners, I knew of one at that time.

Q. Does Schalk produce a liquid brush cleaner today? A. We do.

Q. How many competitors do you have today?

A. Approximately 20. [109]

Q. What other products did you recommend?

A. Recommended a paint and varnish remover.

Q. That was a liquid? A. A liquid.

Q. That was in 1946? A. During 1946.

Q. Were there any products of that nature on the market at that time?

A. Yes; there were possibly three or four. There was only one important one that had started to break into the market, and they were not, it wasn't common enough to be an obstacle.

Q. You recall when Schalk put that product on the market?

A. We put a paint and varnish remover, liquid paint and varnish remover, two liquid paint and varnish removers on the market in 19——

Q. Approximately?

A. Approximately 1956.

Q. How many competitors were there at that time that were producing the same product?

A. Probably 35 or 40.

Q. You mentioned liquid starch in your prior testimony. Was that also recommended in 1946?

A. That was recommended in either 1945 or '46 by [110] Mrs. Farman in my presence.

Q. Was there any liquid starch product on the

(Testimony of Gerald I. Farman.)

market at that time? A. There were not.

Q. What is the situation today?

A. It is liquid starch made by several companies today, but the main one here on the coast is a thing called Vano Corporation in San Francisco, who put out the first liquid starch, I believe.

The Court: You have mentioned from time to time various recommendations that Mrs. Farman made either alone or in conjunction with you or recommendations that two of Mrs. Farman's sisters have made. Did you outline briefly just what experience they had had in either the fabrication of such products or of their knowledge of market conditions that would warrant the assumption that such products could possibly profitably be distributed?

The Witness: Mrs. Marlow and Mrs. Farman, as housewives, were interested in finding products that were, would make their housework easier and make the home a better place in which to live, so they were natural as housewives.

Mrs. Farman, your Honor, was an employee of the company at this time, and the duties that were outlined in her employment was the study of the market, of market conditions, of the study of and research on new products. [111]

She had as an adviser Dr. Diehl here in Los Angeles and was paying Dr. Diehl personally out of her own pocket.

Does that answer?

Q. (By Mr. Hall): Now, during the period that

(Testimony of Gerald I. Farman.)

you were employed by Schalk Chemical Company, in addition to the matters you have testified to before, were there any other matters that the—became of concern to you and to Mrs. Farman and the rest of the family in a matter of controversy with Mr. Smith and his management?

A. There were many. I will try and——

Q. Start with the first one.

A. I mentioned before Mr. Lieben's appointment as general manager in 1944, the refusal to modernize production, refusal to spend any money on research.

Mr. Gardner: If the Court please, is this witness testifying as of the time when he was associated with the corporation?

The Witness: I am.

Mr. Gardner: Or is this hearsay?

The Witness: No; I am testifying from September, 1945, through 1946.

Mr. Gardner: Thank you, sir.

Q. (By Mr. Hall): Mr. Farman, did you do anything about production [112] methods in 1946?

A. I did.

Q. What did you do?

A. I recommended the purchase of two pieces of equipment that were, that made it possible for us to produce the products that were sold in 1946.

Otherwise, we wouldn't have been able to have hit our sales peak under the old methods.

Q. Were there any other matters that came up during that year that were a matter of controversy?

(Testimony of Gerald I. Farman.)

A. One specific point I would like to mention is the matter of expansion of shop, the matter of new products that were so necessary for the continuation of Schalk as a company.

We were virtually out of business because of lack of raw materials. From there we went into production—— [113]

* * *

Q. (By Mr. Hall): Did you make any recommendation in 1946 with reference to the expansion of the Chicago plant? A. I did.

Q. What was that recommendation?

A. The Philco Building became available during 1946 at a price that Mrs. Farman and I, who inspected the building, felt we could pay, and recommended it to Mr. Smith.

Q. What were the conditions at the Chicago plant? Would you describe the conditions at the Chicago plant which required expansion?

A. Our space was not adequate to expand our facility, our products, and build new products.

Q. In what respect, Mr. Farman? [115]

A. The square footage of floor space is the main thing.

Q. Was it overcrowded?

A. It was overcrowded.

Q. In what respect was it overcrowded?

A. Our raw materials were being purchased in carload lots, which required a lot of space for storage, and we obtained new equipment to pieces of new equipment which took up space.

(Testimony of Gerald I. Farman.)

Our business during 1946 was, the volume was far greater than any other year in the history of the company, and naturally it required a terriffic lot of space to manufacture these to meet this production.

Q. Was there any consideration of the liquid products that were contemplated at that time in connection with the facilities?

A. The liquid products had all been turned down by Mr. Smith and Mr. Lieben.

Q. In connection with your recommendation that the facilities be expanded, did you have a plan or an arrangement whereby you could purchase other properties or acquire other property? [116]

A. The Philco Building was one block north of our present plant, and it was on the market at $118,000. It was adequate for expansion, probably would have taken care of the production up to now.

Q. As an officer of the company, what money, to your knowledge, was spent for advertising in 1946? A. Approximately $97,000.

Q. In 1945? A. Approximately the same.

Q. 1947? A. Approximately the same.

Q. Was that a matter of controversy, Mr. Farman?

A. It was a very definite, was a matter of controversy, not between Mrs. Farman and Mr. Smith, but between his two sisters, Mrs. Marlow and Mrs. Baker, and Mrs. Farman, and myself, and Mr. Smith.

Q. Who was Mr. Jacobs?

(Testimony of Gerald I. Farman.)

A. Mr. Jacobs was a chemist that I recommended be employed to produce new products for Schalk Chemical Company.

Q. When did you recommend that Mr. Jacobs be employed?

A. It was during 1946, in the early part of '46.

Q. Was he employed? A. He was.

Q. How long did he remain employed by Schalk Chemical? [117]

A. He was fired in March, 1947, my best recollection.

Q. Did you object to the firing of Mr. Jacobs?

A. I did.

Q. Who was he fired by? A. Mr. Smith.

Q. As a director and an officer of Schalk, did you study the financial statements of Schalk in the years 1945, '46 and '47? A. I did.

Q. What did you notice with regard to costs of goods sold?

A. The ratio of cost of material to the cost of goods sold was fast increasing, which meant that, in other words, the raw materials costs were going up very rapidly.

Q. Was labor going up also?

A. Labor was also going up.

Q. Did you make any recommendation because of that fact?

A. I first recommended that we raise, increase our list price.

Q. When was that recommendation made?

(Testimony of Gerald I. Farman.)

A. That was first recommended in the latter part of 1945.

Q. Who did you make that recommendation to?

A. To Mr. Smith, and it was then recommended by the [118] executive.

Q. Were the prices increased?

A. They were not.

Q. In '46 or '47? A. They were not.

Q. Was any equipment disposed of by the company during the period '46 and early part of '47?

A. Mr. Smith gave an automobile to one of the salesmen that quit because of his being retired, because of his age.

Q. By gave, what do you mean?

Mr. Gardner: May I inquire further, how did you know that, Mr. Smith——

The Witness: I was there, sir.

Mr. Gardner: Very good, sir.

The Witness: I objected very seriously because automobiles were in short supply, very impossible to buy, and I thought that the company ought to keep the car.

He proceeded to tell me that it's none of my business.

Q. (By Mr. Hall): During the period '45, '46, did Schalk Chemical Company sell products to chain stores? A. They did not.

Q. Did you make any recommendation? [119]

A. I did.

Q. In that regard?

(Testimony of Gerald I. Farman.)

A. I recommended we expand our market by selling to chain stores.

Q. By chain stores, what do you mean?

A. Newberry, Kress, Grant, chains known as five and ten cent stores.

Q. Does Schalk sell to those outlets?

A. We have about four outlets at the present, J. J. Newberry and W. T. Grant, we have Sears, that we didn't have at that time, and we have several small five and ten cents stores that we sell direct to.

Q. You mentioned, Mr. Farman, that in terms of sales 1946 was a high year. In your opinion, why did this occur?

A. We were shipping in 1946 orders that were dated in June, 1945. From June on through '45. We were unable to ship them because of no raw materials. Actually 1946 sales are not sales that or orders that were received in 1946; they are 1945 and '46.

Q. What type of account was Schalk serving to a large extent in 1946, I mean, what type of customer accounts?

A. They were serving paint stores and hardware, wholesalers, some retail stores.

Q. Were there any other type of accounts that were peculiar to that period? [120]

A. During the period 19—latter part of '45 during my employment with Schalk, in '46, the retail stores and wholesalers alike could sell anything they could buy. They naturally would like to or pre-

(Testimony of Gerald I. Farman.)

ferred selling products that they were geared to sell, but they bought Schalk products because if they could get them, they at least ordered them, and many other products, but Schalk products specifically that we're talking about, just to have something to sell.

Their shelves were not bare, but in bad shape. All merchants were.

Q. Do you have an illustration of such an account?

A. One illustration I can give you, several, one of them here in town was Goff Industries.

Q. What is Goff Industries?

A. They are an electrical wholesaler.

Q. Do you sell to Goff Industries?

A. No, sir.

Q. When was the last time that you sold to them? A. 1946.

Q. Now, reverting, Mr. Farman, to the executive committee arrangement that you testified was set up in September of 1945, I believe, and continued until at least in power until some time in 1947, how quickly after it was set up did it show signs of not being workable? [121]

A. My answer would be immediately, within 30 days.

Q. Why, what was the occasion at that time that indicated that it was not workable?

A. I don't specifically recall.

There were so many occasions that I don't recall

(Testimony of Gerald I. Farman.)

the first occasion other than that Mr. Smith proceeded to ignore the committee and——

Mr. Gardner: If the Court please, that is a conclusion, and I regret very much the necessity of making objections continuously to this type of testimony.

Mr. Hall: The objection is well taken.

Q. (By Mr. Hall): The executive committee was an arrangement to settle the disputes, so to speak, was it not?

A. That was the purpose of the executive committee.

The Court: Did you have meetings of the committee?

The Witness: Yes.

The Court: How often did it meet?

The Witness: We met every day. Officially we set it up to meet once a week as official body, but we were together every day. We were working together.

The Court: Were any minutes kept of the meetings?

The Witness: Yes, they were, by me.

Q. (By Mr. Hall): In 1945 and '46, were any other plans suggested [122] for the settlement of the dispute that existed at that time?

A. Yes; several suggestions offered. I don't recall the first one now, Mr. Hall. There were many suggestions offered.

Q. Do you recall any of them? What other

(Testimony of Gerald I. Farman.)

methods were proposed to settle this dispute with Mr. Smith?

A. Mr. Smith proposed that he would get out for a given amount of money.

Q. What did he want to get out?

A. He asked, his first request was, he said he would get out for $25,000 as president of the company. He later retracted and made it $50,000.

Q. When was this, Mr. Farman?

A. It was during 1946.

Q. Were there any other suggestions as to the manner of settling it, by employment contracts or otherwise?

A. We included this time all of the family, Mrs. Marlow, Mr. Marlow, Mrs. Baker, Mr. Baker, Mrs. Farman and myself, offered him an eight-year contract to act in a capacity that he was qualified to act and with a minimum wage.

Mr. Gardner: If the Court please, that is another conclusion, acting in the capacity he was qualified to act.

That is the opinion of this witness, and I think the record should show clearly that that is merely his own [123] opinion.

Mr. Hall: Yes.

Q. (By Mr. Hall): Will you state exactly what the proposal was, Mr. Farman, if you recall?

A. We proposed an eight-year employment contract with a minimum salary. I can't tell you what the salary was.

Q. A guaranteed minimum salary?

(Testimony of Gerald I. Farman.)

A. Guaranteed minimum salary for eight years.

Q. As part of that proposal, what was the proposal with respect to the supervisor of the trust?

A. That he would resign as supervisor in favor of Mrs. Farman.

Q. What was proposed with regard to his job with the company, I mean, he was to be employed for eight years?

A. In a capacity, he was to remain in a capacity of, oh, may I word it this way: We were going to set up a workable executive committee and not pin down to the unanimous vote of all, the majority vote, and he was to serve on this executive committee and as one of the directors of the company.

Q. In the early part of 1947, I believe you stated your employment you said with Schalk Chemical Company. Following that situation, what steps were taken to settle [124] the dispute still existing?

A. In 1947?

Q. 1947. A. Oh, we started suit.

Q. By we, who do you mean?

A. The family started suit. I believe it was Mr. and Mrs.—no, Mrs. Baker and Mrs. Marlow, and, I believe, they were the ones that started the suit.

Q. Was that discussed by the family, and with whom?

A. It was discussed with Mrs. Farman and all members of the family, including Mrs. Marlow's husband and Mrs. Baker's husband.

Q. The suit was filed, it is part of the record that is attached to the stipulation, what else oc-

(Testimony of Gerald I. Farman.)

curred in 1947 with regard to settlement of the dispute?

A. Well, due to the fact that the suit had been started, negotiations continued for the settlement.

Mr. Gardner: If the Court please, may I interrupt?

I don't believe that this witness is qualified to testify regarding the results of this suit or what went on during the suit. He is not a party to that suit.

Q. (By Mr. Hall): Did you have anything to do with the filing of that suit?

A. I did. [125]

Q. What did you have to do with it?

A. I was in Mr. Guthrie's office at all times, when there were any controversy or any negotiations, or at any time that plans were laid prior to the suit and during the suit.

Mr. Gardner: If the Court please, I still object to the testimony of this witness relating to that suit on the grounds that he is not a party to that suit. He is nothing but a spectator.

Q. (By Mr. Hall): In 1947, Mr. Farman, were meetings held with Mr. Smith in an attempt to negotiate a settlement? A. They were.

Q. Of the dispute? A. They were.

Q. Where were those meetings held?

A. In Mr. Guthrie's office, in the Pacific Mutual Building.

Q. Who was usually present at those meetings?

A. Mrs. Farman and I were always present at

(Testimony of Gerald I. Farman.)

the meetings. Mrs. Marlow and Mrs. Baker were there at most of them.

Q. Was Mr. Smith present?

A. Mr. Smith was always present, yes.

Q. Was Mr. Wackerbarth, his attorney, [126] present?

A. On one or two occasions, only, that I know of.

Mr. Hall: Mr. Clerk, will you mark that as Petitioner's Exhibit 16, for identification?

The Clerk: Exhibit 16 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 16 for identification.)

Q. (By Mr. Hall): Mr. Farman, were you present at a meeting on January 15, 1948, at Mr. Guthrie's office? A. I was.

Q. Who else was present at that meeting?

A. Mr. and Mrs. Marlow, Mr. and Mrs. Baker, Mr. Smith and Mrs. Farman, Mr. Guthrie, of course.

Q. Was Mr. Wackerbarth present?

A. I can't say. I don't recall.

Q. Was an agreement signed at that meeting?

A. Yes, sir.

Q. Did you personally see the parties to the agreement sign it at that meeting?

A. I did.

Q. I hand you a document which has been marked Petitioner's Exhibit 16 for identification, and ask you if that is the agreement which you refer to? A. This is the agreement. [127]

(Testimony of Gerald I. Farman.)

Q. In your prior testimony? Is that the agreement? A. This is the agreement.

Q. Would you describe what it is, that is, who the parties are and the date of it?

A. The parties to the agreement are Mrs. Farman, Evelyn Smith Marlow, Patricia Farman Baker, and Horace O. Smith, Jr.

Q. The date of that agreement?

A. The date of the agreement is January 15, 1948.

Mr. Hall: I offer this in evidence as Petitioner's Exhibit 16, your Honor.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 16 was received in evidence.)

Q. (By Mr. Hall): That is what we may from time to time refer to as the settlement agreement. Now, Mr. Farman, did you participate in most, if not all, of the negotiations leading to the exhibit which is Petitioner's Exhibit 16? A. I did.

Mr. Gardner: Your Honor, I object to that question. That calls for a conclusion of this witness as to whether or not he participated in all of them. He is not a party [128] to this agreement. His name isn't on that agreement any place, and I object to that type of a question from this witness. He doesn't know.

(Testimony of Gerald I. Farman.)

The Court: Will the Reporter read the question?

(Record read.)

The Court: I will let the witness answer that.

The Witness: I did.

Q. (By Mr. Hall): Over what period of time did those negotiations take place, over what period of time? A. Leading up to this?

Q. Yes. A. I would say from all of 1947.

Q. Now, during that period and prior thereto and up to the time of that agreement, did you make further studies and inquiries as to Schalk's financial condition?

A. During the time that we negotiated the agreement? Will you give me the question again?

Q. Yes. Were you keeping in touch as a director of Schalk with the financial condition of the company? A. I certainly was.

Q. In these negotiations were you authorized to represent anyone?

A. I was authorized to represent Mrs. Marlow and Mrs. Baker. [129]

Q. Were you authorized to represent Mrs. Farman? A. I was.

Q. As a representative and individually in 1947 and the beginning of 1948, Mr. Farman, what was your opinion or let me state it this way, did you have any opinion as to the condition and future prospects of Schalk? A. I did.

Q. What was your opinion?

(Testimony of Gerald I. Farman.)

A. My opinion was that Schalk was very much on the downgrade.

In fact, it was, had a limited life, because of no future products development.

Q. On what did you base that opinion, Mr. Farman; could you tell us the items?

A. Well, I can tell you the items, yes.

The trend at that time was towards more modern products, products that were easier to use, faster and more convenient to use.

I base my statement that Schalk was fast becoming a firm that would not continue in business on the fact—a known fact—that DuPont used a ten-year yardstick as to the length of life of a product from the time it's first marketed until it hits its peak.

Schalk's products, some of their products were much, had gone far beyond the ten years without any [130] improvement in formula.

The sales analysis that I personally made indicated that the products had already started downhill in 1938 and '39, and had it not been for the war, Schalk would have been out of business, but the war, as I stated before, created a demand for products.

Mr. Gardner: If the Court please, this is just a series of conclusions and opinions. I dislike to interject this same objection, but it does get rather tiresome, your Honor.

The Court: He was asking for an opinion, and his opinion may well be relevant, and I will let the answer stand.

(Testimony of Gerald I. Farman.)

Mr. Hall: I was asking what the facts were.

Mr. Gardner: He is bringing in other conclusions, now in answering his opinion.

Mr. Hall: That was his opinion, Mr. Gardner, as to the products, and he was stating the basis for his opinion.

Mr. Gardner: Very well.

Q. (By Mr. Hall): What was the financial condition of Schalk at the end of 1947?

A. Schalk lost approximately $32,000 in 1947.

Q. Was that one of the factors which you based your opinion on? [131] A. Absolutely.

Q. Mr. Farman, I hand you Petitioner's Exhibit 9, which is the audit report of Schalk Chemical Company for the year ended December 31, 1947, and I direct your attention to the balance sheet as of December 31, 1947, and the first item under current liabilities, which is a note payable to the Union Bank.

Do you know when that note was payable, was due, Mr. Farman?

A. It was due in September, 1947. I believe I'm right on that date.

It was due in 1947, the latter part.

Mr. Hall: May I have this marked?

The Clerk: Exhibit 17 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 17 for identification.)

Q. (By Mr. Hall): Mr. Farman, are you familiar with the signature of Horace O. Smith, Jr.?

(Testimony of Gerald I. Farman.)

A. I am.

Q. I hand you a document which has been marked Petitioner's Exhibit 17 for identification, and ask you if that document bears Mr. Smith's signature? A. It does. [132]

Q. Would you describe what Petitioner's Exhibit 17 for identification is?

A. This is a note signed by Schalk Chemical Company, Mr. Horace O. Smith, Jr., and Henry Wackerbarth, in the amount of $2,500.

Q. I believe this is $20,000.

A. $20,000. It was dated October 29, 1947.

Q. That note shows the due date of January 29, 1948? A. That's correct.

Mr. Hall: I offer this in evidence as Petitioner's Exhibit 17.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 17 was received in evidence.)

Q. (By Mr. Hall): Is that the note that is referred to in the first item under current liabilities?

A. That is this note here, yes. [133]

* * *

Q. (By Mr. Hall): Mr. Farman, prior to the noon recess you had stated your opinion in 1947 and beginning of 1948 as to the future of Schalk, and you were stating the factors upon which you base your opinion.

(Testimony of Gerald I. Farman.)

I do not recall at what point where you left off, but would you like to state the factors again, please, or continue stating them?

A. The fact that we, that the Schalk Chemical Company lost money in 1947.

Q. Would you continue, Mr. Farman? You were speaking about the year 1947.

A. The company suffered a major loss in 1947 of $32,158. The fact that they owed money to the bank, the fact that their case was pretty much depleted, led me to believe that the company could not suffer another major loss in 1948. In fact, I was, I firmly believed that the company would not survive the end of the trust, the conclusion of the trust.

Q. And that belief was based upon a continuation of the management that was then in control, is that correct? A. That is true.

Q. What was your opinion, in your opinion what was [135] the reason Schalk Chemical Company having a low working capital at that time?

A. In 1946 the company paid out a very large dividend in the amount of $54,000 or $55,000, and it was because of that that our working fund was, the company's working fund was as low as it was.

Q. Also was your opinion based on any trends within the company itself? By trends, I mean any trends as to products or as to profit and loss over the years, sir?

A. In 1940 the company also, this was a post-war year, and the company also lost money.

Q. What was——

(Testimony of Gerald I. Farman.)

A. Then after the war it lost. Pardon me, you started to ask me a question?

Q. No, go ahead.

A. The trend in the late '30's that caused this loss of the product decline, and I felt that during the war it was the war economy that brought the products back and enjoyed the benefits of the profits we made during the war years, but again back in 1947 we found a pattern or what I felt was a pattern of another decline after the post-war years.

Q. Do you have any products specifically in mind?

A. I had, yes, that was why I was looking for this notebook, because I jotted down some figures.

I used two products here, Hydropura is one of them. [136] Back in 1922 the company sold $270,244 worth of Hydropura. Back in 1931 the sale was $14,363.

Now, the other product that I took, I just took two products, didn't want to go into this deeply, was the largest profit item that we had. It was a 75 list seller, Double X, and Double X—in other words, Double X was the leader in the line, and Double X in 1937 the sales were $104,209, and in 1940, they had declined to $78,000.

This decline was a lot due to the trend in the over-all picture—the over-all market.

For instance, in the field of Double X, Hydropura, or in the field of Double X the electric sanders had come into the picture and were a rental item.

(Testimony of Gerald I. Farman.)

Well, Double X was designed to take the varnish off from the floors. They could rent a sander, and in the opinion of practically a lot of the people the sander was an easier and quicker method of removing the varnish from the hardwood floors.

That trend——

Q. In the use of Double X, how long does it or what is the method that is applied?

A. The method is very hard to remove varnish with Double X. You have to have boiling water to start with, and you put the powder in the boiling water and mop it on the floor and get down and with a scrub brush or, in many instances, steel wool and remove the varnish, which is the [137] hard way to do it.

Q. In 1947, what trends outside of the company did you have in mind? A. Well——

Q. Basis of your opinion?

A. That was one of them; the ease of application of all of our products, were very difficult, very hard to do. The Savabrush would require 48 to 60 hours to soften a hard paint brush. Liquid brush cleaners were coming on the market. They would soften a brush and clean a brush overnight.

The do-it-yourself trend was very definitely on its way, had a very good start, and our products—it was very essential that we tie it in with this do-it-yourself trend.

Q. In your opinion, did the prior management in any way tie into that trend? A. They did not.

Q. What was the result of that failure to do so?

(Testimony of Gerald I. Farman.)

A. Competition came in very strongly and came in with products that were easy to use or easier to use, certainly, than our old fashioned methods of powdered products.

Q. Did inflation in any way affect your opinion?

A. It certainly did. We were definitely paying terrifically high prices and they were increasing, not yearly, [138] but monthly, and this inflation caused me to believe that if we were to survive, another reason if we were to survive, that we would have to increase our prices, our list prices, and we'd have to do something about competition by meeting the discounts allowed by competition, which we were not meeting.

Q. At that time Schalk was producing certain products which were allied to the paint industry, were they not?

A. They were. Their products were all associated.

Q. Associated paint products? A. Yes.

Q. Was there any dangers in that, Mr. Farman?

A. I felt definitely that we should diversify our products, and talked at length with management about diversifying into other fields. This was not an unusual thing. The other companies, similar companies, were diversifying as fast as they could in fields not directly associated in the paint industry.

The Court: When were these discussions?

The Witness: During 1947, is the date that I understood.

The Court: Did you have any discussions of this

(Testimony of Gerald I. Farman.)

character after the filing of the suit in April 11, 1947?

The Witness: We still continued to negotiate a settlement, sir. [139]

Q. (By Mr. Hall): And also Mr. and Mrs. Farman were directors of the company at that time.

What was the danger in being limited to the associated paint products field, in your opinion?

A. At that time there was some indication that the large, the major paint companies would produce their own products. That would definitely eliminate the sale of Schalk to these companies. They would sell their own brand names.

I'm speaking specifically of Pittsburgh Plate Glass, Sherman-Williams, and all of their associated companies.

There was a definite indication that they were going to do that, and some of them, some of the products were on the market at that time under their brand name.

Q. Did the dispute that was going on with Mr. Smith and the rest of the family, did that affect your opinion in any way? A. It certainly did.

My purpose of continuing negotiations and trying to settle this thing was that I felt very definitely that the company couldn't survive under the conditions that were existing, the contention and so forth.

The Court: Was that point of view the same point of [140] view that you held at the time the suit was instituted?

(Testimony of Gerald I. Farman.)

A. Yes, sir. I felt that way when we instituted the suit.

The Court: Was there any evidence at that time of an adverse earnings picture?

The Witness: Oh, the adverse earnings were actually, I think, just started in March or April of 1947.

The Court: According to Exhibit 2, the suit was actually filed, the complaint was filed on April 11, 1947, and it is a rather lengthy document.

I would imagine that the determination to file this suit was arrived at at some point considerably earlier than April 11, 1947, was it not?

The Witness: I think it was, Judge, your Honor. I felt that, as many of them did, meaning the principals, stockholders, that it was necessary to do something or the company would be completely out. Nothing being done toward a new product type of thing as I mentioned this morning. Definitely something had to be done to remove the management and get the thing on a basis so that it would survive.

The Court: My questions are directed not so much towards the diversification of products, or the improvement of products, as they are towards the actual earnings picture of the company, and as I look at Exhibit H, the audit report [141] for 1946, there appears to have been a very favorable earnings picture for the year '46, the last full year before the filing of this suit.

The Witness: Yes.

(Testimony of Gerald I. Farman.)

The Court: And, therefore, rather puzzled am I by your statements about adverse earnings.

The Witness: May I——

The Court: You are sure there were adverse earnings in the year '47 but that was the year it was completed, a good many months after the determination to file the complaint in the suit? I would appreciate having any comments you can make.

The Witness: The only thing I made plain, first, the large earnings in 1946 may be attributed to, one, we were shipping orders received as far back as June, 1945. We were shipping those orders in '46.

Number two, we had been able to obtain by instigating and negotiating new contracts with suppliers to fill all of the orders we had on hand. The market at that time was the market, being in the trade, were clamoring for any type of product they could get to sell.

The people had the money to buy and products were, many many commodities were in short supply, and it was a very hard thing for the market, the trade, to find products to sell. They were selling shop products. There [142] were many companies selling Schalk products that didn't do it in '47.

Q. (By Mr. Hall): Also, Mr. Farman, my question was directed to your opinion as of the time of the settlement agreement, at which time there was a question of whether to proceed with the lawsuit or to settle it, and that was in early '48, and at that time you were aware of the lawsuit, is that correct?

A. Certainly was.

(Testimony of Gerald I. Farman.)

Q. You became president, you testified, on January 15, 1948.

Shortly after that did you make a survey of Schalk's accounts? A. I did.

Q. In what manner or procedure did you do that?

A. I covered the middle west. I travelled by automobile covering the middle west, the south, and the eastern seaboard, calling on all major accounts.

Q. For example, would you give an illustration of the accounts you called on?

A. I naturally covered the two major accounts in the United States, Sherman-Williams in Cleveland. That's their main office. Also Pittsburgh Plate Glass in Pittsburgh, Pa. But I covered such accounts as the wholesale hardware [143] accounts in Cleveland, Worthington Company, Bingham, Belknap down in Louisville.

The Court: At what time was this?

The Witness: In 1948 shortly after I became president.

The purpose of this was to make a survey of Schalk's position in the market and trend towards new products.

Mr. Gardner: If the Court please, I fail to see the materiality of his testimony as to what this witness did after the agreement in question was executed. He is now the president and all the acts that have taken place now, what he does now, I don't see has any relevancy on this case at all.

Mr. Hall: Your Honor, a survey was made

(Testimony of Gerald I. Farman.)

shortly afterwards, and I think the Petitioners are entitled to state their opinion as to the result of that survey, which is close enough to the key time to show some evidence as to why they moved as they did in 1948.

The Court: It rounds out the picture.

I will receive the evidence.

Q. (By Mr. Hall): Mr. Farman, how long did it take you to make this survey?

A. About seven weeks.

Q. How many accounts would you say you contacted, [144] roughly?

A. Roughly about 2,000 accounts.

Q. In your opinion, what was the attitude of Schalk's accounts at that time, as far as the Schalk line of products was concerned?

A. Will you reword that?

Q. In your opinion, what did you determine was the attitude in the industry towards Schalk at that time?

A. In this case I would like to be specific, very specific.

Belknap, who is the largest wholesale hardware in the world, Charlie Coble in the buyer department, specifically said, you're a nuisance.

Mr. Gardner: I object to that as hearsay.

The Court: Overruled.

Q. (By Mr. Hall): Continue, Mr. Farman.

A. He said, we like you. You're a small company, a good company, probably, but your products are

(Testimony of Gerald I. Farman.)

outdated. You are back in the horse and buggy days, and you are a nuisance account to us.

I had to inquire what a nuisance account was. I had never heard the expression before.

Pittsburgh Plate Glass invited me out when I went in by stating that we have asked the Schalk Chemical [145] Company to come over and see us, and they told us to come see them.

Sherwin-Williams——

Mr. Hall: All right.

Q. In your opinion, what was Schalk's standing in the industry at that time, at the time of this survey, in your opinion?

A. My opinion was it was a has been, that Schalk was a has been, if that is satisfactory. It had been a good company.

Q. In your opinion, was Schalk standing in the industry—what is Schalk's standing in the industry today, in your opinion?

A. Schalk has been a leader for several years. They have put out more products than any one company in the field, as evidenced by our——

Q. What do you mean by leader?

A. They are the largest manufacturer of home repair and associated paint products.

They are in two fields today. They are the largest manufacturer in a number of products.

The Court: Speaking of the number of products or the gross receipts or what?

The Witness: No, the number of products.

(Testimony of Gerald I. Farman.)

That's what I tried to qualify, Judge, I'm [146] sorry.

Q. (By Mr. Hall): Why is the number of products an important consideration?

A. The trend, in fact this is more than a trend today, it is necessary in today's markets, to cut for, the wholesaler to cut inventories to the bone, and to cut expenses.

Expenses have climbed to the point where it is very essential to cut them. It is preferable, and as borne out in our own operation for a company to buy as much as they can from one source. This is developing more and more as 1958 progresses.

Q. Since you became president of Schalk Chemical Company, Mr. Farman, what has been the dividend policy of the company?

A. We have not paid a dividend. I advised the stockholders when I went in as president that I wanted their permission to bury or plow back into the company as much as I possibly could earn for building a long-lasting substantial business.

To do that, it required a lot of money, required money to put new products on the market. We have introduced, I believe it was, brought out nine new products in the last ten years.

Q. Have you presently any negotiations going on for the acquisition of facilities in Chicago? [147]

A. We have. We have been over a period of years, since 1949, 1950, where we got back in volume, it was absolutely necessary to increase our facilities by new and larger buildings, and we have been ne-

(Testimony of Gerald I. Farman.)

gotiating for several years to find a cheaper location where we could or find a building already built where we could produce new products that we have in many instances tested and are ready for the market but we are handicapped because of cramped facilities.

Mr. Hall: May I have Plaintiff's Exhibit 16.

Your Honor, excuse me just a moment.

Q. Mr. Farman, I hand you Plaintiff's Exhibit 16, which is, with permission of Counsel, I may call the settlement agreement, you have testified that there was a meeting on that date and that you were at that meeting and saw that document executed with that meeting. Were other papers executed on that date, within your recollection?

A. I wouldn't know without studying this. There were other, there were certain bases that were a part of this settlement agreement.

Q. We have in evidence as Plaintiff's Exhibit 4, Mr. Farman, a release dated January 15, 1948, signed by Mrs. Farman, Mrs. Marlow and Mrs. Baker in favor of Mr. Elmer J. Jensen. Would you state who Mr. Jensen was?

A. Mr. Jensen was Mr. Colyear, Mr. Colyear a former president of the company, manager I believe, and was a [148] director of Schalk during Mr. Jensen's or Mr. Colyear's reign as president.

Q. Did I understand you to say that Mr. Jensen was a manager of Schalk?

A. Of, I'm sorry, of Colyear Motor Sales.

Q. But he was a director of Schalk?

(Testimony of Gerald I. Farman.)

A. He was a director of Schalk.

The Clerk: Exhibit 18 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 18 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you a document that has been marked Petitioner's Exhibit 18 for identification, and ask you if that document bears the signature of Mr. Horace O. Smith, Jr.?

A. It does.

Q. Would you describe that instrument, just the title of it and the date of it?

A. It's dated January 15, 1948, consent to cancellation of portion of dividend declared.

Mr. Hall: I offer this as Petitioner's Exhibit 18.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 18 was received in evidence.) [149]

The Clerk: Petitioner's Exhibit 18.

Mr. Hall: I am sorry, your Honor, I would like to have the witness have that agreement, please.

The Court: Exhibit 16?

Mr. Hall: Yes.

Q. (By Mr. Hall): Mr. Farman, you have in front of you the settlement agreement, which is Exhibit 16, and you have testified that negotiations leading to that agreement took place over several months' period, and I don't recall your testimony, so

(Testimony of Gerald I. Farman.)

I ask you the question again; where were the meetings held to discuss the settlement agreement?

A. At Mr. Guthrie's office in the Pacific Mutual Building.

Q. Did you attend all of those meetings?

A. I attended every meeting. My office was also adjoining there, and I attended every meeting.

Q. What proposals were made at those meetings by way of settlement of this entire problem?

A. By way of settlement the eight year agreement that we offered employment to Mr. Smith.

Q. This is in 1947, Mr. Farman?

A. That occurred in 1947. We offered employment to Mr. Smith on a contract of employment guaranteeing him eight years, that he remain on the board. [150]

Mr. Gardner: Might I inquire again as to who we are?

The Witness: The stockholders of the Schalk Chemical Company, Mrs. Farman, Mrs. Marlow and Mrs. Baker.

The Court: Were you taking an active part in the negotiations?

The Witness: Yes.

The Court: Were you representing Mrs. Farman's interest?

The Witness: Mrs. Farman and the two girls.

Mr. Hall: I think there was testimony to that effect, your Honor.

Q. (By Mr. Hall): Can you be more specific,

(Testimony of Gerald I. Farman.)

Mr. Farman, as to what the proposals were, let's say, from your side of the fence?

A. I definitely recall that we offered eight years, an eight year contract, to Mr. Smith, that he remain on the board as a director, that he remain an employee of the company and receive a salary for his services.

I recall that one very well, and it was turned down.

Q. Were there any other proposals?

A. There is no doubt of other proposals. I just haven't the key. There were many proposals. We offered everything we could to settle this without getting into a wrangle.

Q. What did Mr. Smith propose? [151]

A. Mr. Smith first said I'll get out if you'll pay me $25,000.

Later he retracted it and made it $50,000.

Q. When did he make that type of a proposal?

A. During the latter part of 1947.

Q. You say he retracted the offer to take $25,000 and made it $50,000? A. Yes, sir.

The Court: What did you understand him to mean by saying I'll get out?

The Witness: I understood that he would——

The Court: Was there included within that offer, as you understood it, an offer to sell or dispose of his interest in the company, as well as to relinquish any hold that he had on management?

The Witness: Your Honor, the first proposal of $25,000, as I understood it, was that he would resign

(Testimony of Gerald I. Farman.)

as president and relinquish his position as supervisor of the trust in favor of Mrs. Farman.

The second proposal I very definitely understood included his interest, his stock interest in the company.

Q. (By Mr. Hall): Did he at any time, Mr. Farman, offer to give you an option on his stock? By you, I mean the rest of the family? [152]

A. Yes, he did. I would like to go on record that we didn't want his stock. We, meaning Mrs. Farman and her two daughters, were not interested. I was a negotiator in this case, and they were not interested in buying his stock. In fact, they preferred not to buy his stock.

Q. What were they interested in?

A. They were interested in——

Mr. Gardner: If the Court please, I think the witness is to testify as to what he knows of his own knowledge. What they are interested in should be testified to by the people themselves, that is Mrs. Farman, Mrs. Baker and Mrs. Marlow.

The Court: I will let him testify because he represented them in these negotiations.

The Witness: The sole interest of Mrs. Marlow, Mrs. Baker and Mrs. Farman was to reach a peaceful conclusion wherein this business could be operated without fear of it going broke.

Q. (By Mr. Hall): Again I come back to the proposal from your side of the fence, Mr. Farman. What was proposed, either by you or by your attorney, Mr. Guthrie?

(Testimony of Gerald I. Farman.)

A. I'm afraid I'm a blank on it.

Q. Did the company have money at that time to make a settlement? [153]

A. Definitely. At that time, of course, it was always the intention, as far as clear understanding was concerned, that the company would pay Bob this money, but they were, there were many factors that entered into it.

Bob refused to begin with to accept the money from the company. I believe—well, that's an opinion.

Anyway, the idea and the general intent was that the company would pay Bob to relinquish his——

Q. Did you make any proposal in regard to that?

Mr. Gardner: I would like to move that the witness' last answer be stricken for this reason, that he stated it is always the intent of the company to assume this obligation or to take this obligation.

That is the very point we are in issue with right here.

Mr. Hall: May we have it read back?

Mr. Gardner: That is a conclusion that I do not think should be allowed to remain in the record.

Mr. Hall: I don't believe he said that, your Honor.

The Court: I think he did say it.

Mr. Hall: Did he? May we have it read back?

The Court: The Reporter will read it back.

(Record read.)

The Court: No foundation at all has been laid showing that there has been any corporate action

(Testimony of Gerald I. Farman.)

whatever to justify [154] the testimony of the witness that such was the intention of the company, and I will grant the Government's motion to strike.

Q. (By Mr. Hall): Again, Mr. Farman, I would like to ask you what was any or all of the proposals you made to Mr. Smith in counter to his proposal?

A. One of the proposals that we made was that we again institute an executive committee to operate Schalk Chemical Company as a body that was fair and could operate on a majority vote.

He refused that one.

Q. What other proposals were made in 1947?

A. I'm afraid I don't recall what proposals were made other than various plans. We proposed to pay him what he first asked, the $25,000, to get out.

Q. By we, who do you mean?

A. The company, Mrs. Farman and her daughters agreed to that, and he changed his mind on that.

Q. He changed his mind on what, Mr. Farman?

A. On the $25,000 to get out or to resign.

The Court: Did you ever make the offer? I thought he made the offer and it was withdrawn before you ever accepted it.

The Witness: Well, I believe that the time that it was, [155] that he made the offer, we said, well, we said——

The Court: If you had accepted it, there would have been a deal right then and there, would there?

The Witness: I'm afraid not.

Mr. Hall: Your Honor——

The Court: Did you accept?

(Testimony of Gerald I. Farman.)

The Witness: Yes, we were ready to accept.

Q. (By Mr. Hall): At the time of the acceptance of any offer, Mr. Smith had still not executed documents that took away his control, isn't that correct, Mr. Farman?

A. Yes, he was supervisor of the trust, which gave him absolute control over the company and its stock.

Q. Mr. Farman, in 1947, and, your Honor, this witness is having trouble remembering; I have evidence that shows some other facts——

The Court: Proceed.

Q. (By Mr. Hall): Is it not true, Mr. Farman, that in 1947 your proposals to settle with Mr. Smith and the family proposal was that the corporation would pay Mr. Smith; wasn't that your proposal?

A. That was what I was trying to say, but I guess I said it wrong because Mr. Gardner objected.

Mr. Gardner: I would like to note an objection for [156] the record to that question.

Mr. Hall: I appreciate that, Mr. Gardner.

Q. (By Mr. Hall): But what was Mr. Smith's attitude to such a proposal? A. He refused it.

Q. He refused what, Mr. Farman?

A. He refused the offer for the corporation to pay him the moneys to relinquish his position as supervisor of the trust and president of the company.

Q. Now, referring to the agreement that is in front of you——

The Court: Did that refusal embrace also or was

(Testimony of Gerald I. Farman.)

there included in the proposal that was refused an offer to buy him out?

The Witness: Yes, and he refused for the corporation, to allow the corporation to buy him out.

The Court: There are two kinds of offers with respect to which there have been testimony. There was a $25,000 offer which I understand that——

The Witness: Which was rejected.

The Court: Which I understood did not involve this relinquishment of his beneficial interest in the enterprise—involved merely his relinquishing his holding on management, and then I understood that there was a $50,000 offer which [157] embraces both his relinquishment of his beneficial interest in the entire enterprise as well as his control over management.

The Witness: That's right.

Q. (By Mr. Hall): What, in fact, Mr. Farman, was Mr. Smith's demanding at the time this agreement was signed? I mean, what was his intent?

Mr. Gardner: I object to this witness testifying as to what the intent of Mr. Smith was.

Mr. Hall: Strike that.

Q. (By Mr. Hall): What did he state at that time?

A. He stated he wanted $25,000 cash—$25,000 in cash and $20,000 at the termination of the trust.

Q. Now, referring to that agreement, the agreement spelled out a purchase price, $45,000 for the whole interest in the company, Mr. Smith's whole

(Testimony of Gerald I. Farman.)

interest in the company, so to speak, $25,000 payable immediately and $20,000 after the termination of the trust.

You have mentioned that he was willing to take $25,000 to get out and then was willing to give up his stock interest for $20,000. Were the terms changed after that offer and this agreement?

A. The terms were changed to $50,000 and later to [158] $45,000, which is a part of this agreement.

Q. Mr. Smith refused to enter into the agreement if it were with the corporation?

A. With the corporation he refused that.

Q. On the date that agreement was signed, did Mr. Smith state that he was happy or unhappy with that agreement?

A. I don't recall him making any statement about the agreement itself.

Q. Did he make any statement in connection with the agreement? A. Not that I recall.

Q. Did he make any statement about being fearful of getting his $20,000——

A. Yes, he did, very definitely.

Q. Who did he make that statement to?

A. To Mr. Guthrie.

Mr. Gardner: If the Court please, I object to the leading quality of these questions.

Now, he has testified he didn't remember, and then the words were put in his mouth.

This is an important witness, and I think he should remember himself and do his own testifying.

(Testimony of Gerald I. Farman.)

I don't like to object, but there have been numerous instances this afternoon of that. [159]

Q. (By Mr. Hall): Referring to the settlement agreement, Mr. Farman, that agreement calls for $25,000 to be paid to Mr. Smith at the outset, and the agreement recites that Mr. Smith acknowledge receipt of it on that date. Did you and Mrs. Farman pay any part of the $25,000?

A. Yes.

Q. What amount? A. $15,000.

Q. Did that $15,000 come from personal funds?

A. It did not. We borrowed the money. We didn't have the money.

Q. Who did you borrow it from?

A. We borrowed $5,000 from Mr. Guthrie, $5,000 from my mother, and $5,000 from Miss Garrett.

Q. Pardon?

A. We borrowed $5,000 from my mother, and $5,000 from Miss Garrett, Theodora Garrett.

Q. Did you give those persons any written evidence of the loans?

A. We gave them a note involving interest.

Q. Promissory note? A. Promissory note.

Q. Were those notes ever repaid?

A. They were.

Q. When were they repaid? [160]

A. As soon as the trust agreement was completed or terminated.

Q. Were any specific funds used to make the repayment?

A. They were repaid by corporation funds.

(Testimony of Gerald I. Farman.)

Q. By corporation funds do you mean moneys that were paid to you by the corporation?

A. Yes.

* * *

The Clerk: Petitioner's Exhibit 19 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 19 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you Petitioner's Exhibit 19 for identification.

Do you recognize that document? A. I do.

Q. What is it, Mr. Farman?

A. It is a promissory note.

Q. It is a copy of a promissory note?

A. A copy of a promissory note in favor of Laura M. Farman, in the amount of $5,000, signed by myself and [161] Mrs. Farman.

Q. What is the date on it?

A. January 15, 1948.

Q. Is that an exact copy of the note which you gave your mother, Mrs. Farman? A. It is.

Q. In evidence of the loan she made to you?

A. It is.

Q. That note was repaid, is that correct?

A. That is correct.

Q. Do you have the original note? Was the original note returned to you?

A. The original note was returned, yes.

Q. Where is it? Do you have the original note?

A. I do not have the original note.

(Testimony of Gerald I. Farman.)

Q. Do you know what happened to it?

A. I do not know what happened to it. We moved out of the house we were in, and we lost a lot of files.

Mr. Gardner: We do not object to the copy of this document, if that is the purpose, your Honor.

Mr. Hall: For Counsel's information, the—and the Court's, of course, this copy is from our office files and has a pencilled note on it at the bottom by one of the attorneys who was then in the office, and it may be disregarded if Counsel so desires. [162]

Offer this as Petitioner's Exhibit 19.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for Identification as Petitioner's Exhibit No. 19 was received in evidence.)

The Clerk: Petitioner's Exhibit 20 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 20 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you Petitioner's Exhibit No. 20 for identification, and do you recognize that document? A. I do.

Q. What is it, Mr. Farman?

A. It is a promissory note in the amount of $5,000, promissory note dated January 15, 1948, in favor of Theodora Garrett.

Q. Is that a copy of the note that you signed in favor of Theodora Garrett? A. Yes.

(Testimony of Gerald I. Farman.)

Mr. Hall: Offered in evidence as Petitioner's Exhibit 20.

Mr. Gardner: No objection.

The Court: Admitted. [163]

(The document heretofore marked for identification as Petitioner's Exhibit No. 20 was received in evidence.)

Mr. Hall: To save time, your Honor, I have a note in favor, copy of a note in favor of Stanley W. Guthrie, in the sum of $5,000, dated January 15, 1948.

If there is no objection, I will offer that as Petitioner's Exhibit 21.

(The document above referred to was marked Petitioner's Exhibit No. 21 for identification.)

Mr. Gardner: No objection.

The Court: Admitted.

The Clerk: Exhibit 21.

(The document heretofore marked for identification as Petitioner's Exhibit No. 21 was received in evidence.)

Q. (By Mr. Hall): The proceeds of the loans which those notes were given for, the proceeds of the loans for which those notes were given were used for what purpose, Mr. Farman?

A. To pay off this blood money, this $25,000——

Mr. Gardner: If the Court please, I object to the witness' term "blood money."

The Witness: This is what we called it. [164]

(Testimony of Gerald I. Farman.)

Q. (By Mr. Hall): It was used for what purpose? A. To pay Mr. Smith the $25,000.

Q. It was part of the $25,000?

A. Part of the $25,000.

Q. That you paid to Mr. Smith, is that correct?

A. That's correct.

The Clerk: Exhibit 22 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 22 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you Petitioner's Exhibit 22 for identification, and ask you if that document bears the signature of Mr. Horace O. Smith, Jr.? A. It does.

Q. Will you briefly describe what that is?

A. This is a letter addressed to Guthrie, Darling, and Shattuck, attention Mr. Olson, who is attorney——

Q. What is the date of the letter?

A. September 12, 1947.

Mr. Hall: I offer this document as Petitioner's Exhibit 22.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 22 was received in evidence.) [165]

Q. (By Mr. Hall): Mr. Farman, Exhibit 22 states that Mr. Smith was not agreeable to a proposal that had been made by Mr. Olson or Guthrie,

(Testimony of Gerald I. Farman.)

Darling and Shattuck, or from your side of the fence, and offered in return to resign for $25,000, and to cause Mr. Rousch and Mr. Wackerbarth to resign and offers to give the family an option to buy his stock.

Do you recall that offer? A. I do.

Q. Was that accepted by you?

A. Yes. I believe that that was, that offer was made in September.

Q. Those are not the terms that are set forth in the settlement agreement or let me ask you this question; Mr. Farman, did Mr. Smith at any time accept any proposal made by the family?

A. No. The family, we were, it was the other way around. Mr. Smith was making the proposals. All of these proposals came from him. We didn't make these proposals.

Q. Did the family accept any of the proposals of Mr. Smith from time to time?

A. My answer is yes.

Q. But what happened to that acceptance or those proposals?

A. He refused to go through with them. [166]

Q. The $15,000 portion of the $25,000 that was paid to Mr. Smith by you and Mrs. Farman, the $15,000, did you expect to be repaid that $15,000 at the time you made it?

A. Definitely we expected to be repaid.

Q. In what manner did you expect to be repaid?

A. We expected this to be repaid by the corporation.

(Testimony of Gerald I. Farman.)

Q. In what manner by the corporation?

Did you have any specific expectation at that time?

A. It was always the intent that the company would, the corporation would pay back this money that was borrowed to get Mr. Smith's resignation.

Mr. Gardner: If the Court please, the intent of the corporation cannot be established by this witness because this witness was not in control of that corporation at that time.

The Court: He can't testify to the intent of the corporation. The words he used were the intent, and it left me in the dark as to whose intent he was talking about.

Was it your intent?

The Witness: It was the intent of Mrs. Farman, her two daughters, myself, to pay this money, to get this money back.

The family did not have the money. They had to go out and borrow it. That was known to Mr. [167] Smith.

The Court: It was your intention in some form or other to get it out of the corporation ultimately?

The Witness: We first offered, your Honor, and tried to get Bob to negotiate this settlement with the corporation, and he refused.

Then the only alternate we could take was to go out and borrow the money because we were in fact very much concerned over the company's existence and we went out and borrowed the money to include this eruption in the company and to be able to take

(Testimony of Gerald I. Farman.)

it over, and we did not have the money and we had only one source to get it back, and that was through the corporation, and we tried to negotiate with Mr. Smith prior to that for the corporation.

We offered to go out and borrow the money and give the corporation so the corporation could pay him off, and he refused that.

Q. (By Mr. Hall): As a representative of Miss Farman and Mrs. Baker and Mrs. Marlow and as one of the parties paying part of the money, actually paying part of the money to Mr. Smith, I would like you to state, Mr. Farman, what was your intent or yours individually and for the rest of the family in entering into this agreement with Mr. Smith; what was your intent?

A. Our intent, I don't know that—— [168]

Q. What was your purpose?

A. The purpose was to get the corporation out of his control, his absolute control.

Q. In connection with his control, what did Mr. Smith demand in making the settlement, insofar as the stock interest?

A. He demanded that Mr. Guthrie and I personally guarantee—he said that his contention this agreement he didn't like it, that the corporation would go broke before they ever paid off his $20,000, and he demanded Guthrie and I guarantee the $20,000, which we did personally guarantee it.

Q. As president of Schalk Chemical Company, thereafter, Mr. Farman, did you at any time consider any action in 1948 or '49 looking towards what

(Testimony of Gerald I. Farman.)

was ultimately done in 1950 to execute an assignment contract; did you consider that, or if you don't understand my question——

A. I don't understand the question.

Q. I will change it.

As a matter of fact, the assignment agreement was not until 1950, and would you explain why, as president of Schalk, you took no action with regard to such an agreement until 1950.

A. I believe I understand it. Well, to begin with, we were advised by counsel, by Mr. Guthrie and Mr. Darling, [169] that this being a spendthrift trust, until the trust agreement was terminated we could not take a chance of paying the money out of it back to the people that we borrowed it from until Mr. Smith had lived and the agreement was terminated, because if Mr. Smith had not lived, the agreement would be not in effect.

We had no way of getting our money back, in that case, but it being a spendthrift trust, we were advised that we could not possibly, he couldn't turn his stock over until the agreement was terminated.

Q. Mr. Farman, I hand you Petitioner's Exhibit 5, which is the minutes of a special meeting of the board of directors of Schalk Chemical Company on December 15, 1950, and I refer you to the resolution commencing on page 3.

Will you glance at that resolution for a moment?

The Clerk: Petitioner's Exhibit 23 for identification.

(Testimony of Gerald I. Farman.)

(The document above referred to was marked Petitioner's Exhibit No. 23 for identification.)

Q. (By Mr. Hall): You have read the resolution, Mr. Farman? A. I have.

Q. I hand you Petitioner's Exhibit 23 for identification, and ask you if that document bears your signature? A. It does. [170]

Q. That is your signature as president of Schalk Chemical Company? A. It is.

Q. Mr. Farman, would you describe what this Petitioner's 23 for identification is?

A. It's assignment agreement.

Q. Between what parties?

A. Between Schalk—between Hazel I. Farman, Evelyn Smith, Patricia Baker and the Schalk Chemical Company.

Q. Mr. Farman, did you execute Petitioner's Exhibit 23 for identification in accordance with the authorization contained in the resolution which you read in the minutes of the board of directors of Schalk on the meeting held on December 15, 1950?

A. I did.

Mr. Hall: Your Honor, I offer this as Petitioner's Exhibit 23.

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 23 was received in evidence.)

(Testimony of Gerald I. Farman.)

Mr. Hall: Your Honor, I have four checks, and I will number them separately.

The first one, check No. 5234, Schalk Chemical Company, payable to the order of Union Bank and Trust Company, [171] Los Angeles, in the sum of $20,000, offer that as Petitioner's Exhibit 24.

(The document above referred to was marked Petitioner's Exhibit No. 24 for identification.)

Mr. Gardner: No objection to any of these.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 24 was received in evidence.)

Mr. Hall: Offer check No. 5213 of Schalk Chemical Company, dated February 10, 1958, correction, 1955, payable to the order of Evelyn Smith Marlow in the sum of $5,788.13, offer that as Plaintiff's Exhibit 25.

(The document above referred to was marked Petitioner's Exhibit No. 25 for identification.)

Mr. Gardner: No objection.

The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 25 was received in evidence.)

Mr. Hall: I offer as Plaintiff's Exhibit 26, check No. 5248 of Schalk Chemical Company, payable to

(Testimony of Gerald I. Farman.)
the order of Patricia Farman Baker in the sum of $5,788.13, dated February 28, 1951. [172]

(The document above referred to was marked Petitioner's Exhibit No. 26 for identification.)

Mr. Gardner: No objection.
The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 26 was received in evidence.)

Mr. Hall: Finally, I offer as Plaintiff's Exhibit 27, check No. 5204, of Schalk Chemical Company, dated February 10, 1951, payable to the order of Hazel I. Farman in the sum of $17,364.38.

(The document above referred to was marked Petitioner's Exhibit No. 27 for identification.)

Mr. Gardner: No objection.
The Court: Admitted.

(The document heretofore marked for identification as Petitioner's Exhibit No. 27 was received in evidence.)

Q. (By Mr. Hall): Mr. Farman, does Mrs. Farman have any source of income other than from Schalk Chemical Company?

A. No. It's very slight insurance policy, but not considered anything, it's so small.

Q. Now, referring back to your testimony about the time you took annual leave from the position you held at, as [173] chief of supply for the Corps of

(Testimony of Gerald I. Farman.)

Engineers, did in that capacity, were you subject to Civil Service?

A. I was a Civil Service employee, yes, sir.

Q. Did you resign at any time?

A. I resigned in 1946.

Q. Could you have stayed with the Government at that time?

A. Definitely, because it was a professional classification, that of principal engineer and head engineer.

Mr. Gardner: I didn't get the last part.

The Witness: My classification of Civil Service classification was a professional classification, that of head engineer, and principal engineer.

Q. (By Mr. Hall): Mr. Farman, during the years 1935 to 1939, what was your occupation?

A. I was with the U. S. Army Engineers, chief of operations of the WPA—chief of operations of the WPA operations in Southern California.

Q. That was the Southern California Division of the WPA?

A. It was administrated by the Corps of Engineers, U. S. Army.

Q. Approximately how many personnel did you have under your control at that time? [174]

A. Administratively I had between seven and eight hundred administrative personnel, and we were working between 70, and I think our peak was a little over $100,000.

Q. What was your responsibility as chief of operations?

(Testimony of Gerald I. Farman.)

A. The engineering projects were under my supervision, the selection of projects were under my control. However, there were certain projects, certain political subdivisions recommended that went through higher sources and came to me, but generally speaking the minor projects or the ones that didn't have political force back of them were mine.

The actual running of the projects was a part of operations and the efficient running of the projects were a part of operations. The payroll and other parts were also a part of operations.

Mr. Hall: Thank you, Mr. Farman.

You may examine.

Cross-Examination

By Mr. Gardner:

Q. Mr. Farman——

Might I ask the Court how long we will continue tonight?

The Court: I will sit until 4:00 o'clock. [175]

Q. (By Mr. Gardner): Mr. Farman, now that we are on the business of prior occupations, I wonder if we could get a brief rundown of your business history, beginning with your education, sir?

A. I graduated from high school and two years later attended Troop Academy, now Cal Tech, taking a special course, special engineering course sponsored by the Public Utilities of Southern California.

I was selected as one to go to General Electric in Schnectady for further education in 1914, I believe

(Testimony of Gerald I. Farman.)

it was, and I went to Schenectady, I think approximately a year.

Q. You have had three years of education on a college level, is that correct, sir?

A. That was part of it, and I was also selected by General Electric to take the Alexander Hamilton course of business administration, which I completed, and that was approximately a year and a half, I would say.

Q. Do you hold an engineering degree, sir?

A. I do not, no. I don't hold an engineering degree.

Q. You don't have a degree in business administration, either, do you?

A. Oh, no. I maybe received one but I do not have it now.

Q. Where would you have received one [176] from?

A. Business school of Alexander Hamilton School of Business Administration. I graduated, I completed the course.

Q. That had a certificate, did it?

A. Probably got a certificate, but that was many years ago and I do not have it.

Q. What was the duration of that course, one year?

A. About a year. It could have been a year and a half, Mr. Gardner. It's too long ago for me to remember.

Q. Then that was in 1914, approximately, that you went to school, is that correct, sir?

(Testimony of Gerald I. Farman.)

A. Well, summer of '14 and '15.

Q. What positions have you held since that time?

Mr. Hall: Your Honor, I object on the ground that the question is immaterial and incompetent and irrelevant in this proceeding. We have testified as to Mr. Farman's—Mr. Farman has testified as to what he has done since 1935. It would seem that that is sufficient.

The Court: I think it is pretty remote, but we have had comparable remote testimony on direct.

I will permit Counsel to pursue it.

Mr. Gardner: Thank you, your Honor.

Would you read the question back?

(Record read.)

The Witness: I worked for General Electric for one year. [177]

Q. (By Mr. Gardner): What year was that, sir?

A. It was prior to World War I, about '15 or '16.

Q. In what capacity, sir?

A. I guess you'd say sales. I travelled for the United States with Mr. Steinbeck when he introduced the mazda lamp, and I was the business administrator for this tour and took charge of the sales after the introduction of the lamp.

Q. What was your salary, sir?

A. I couldn't tell you. I haven't the faintest idea.

Q. All right, let's go to the next year.

A. After World War I, I was a civilian in World

(Testimony of Gerald I. Farman.)

War I, we had to say that because there are no records of my entry into the Army. After that I was, in fact let me go back prior to World War I, I bought a business on $300 for borrowed cash. After World War I I conducted my own business. In fact, I had three businesses.

Q. What were those businesses?

A. I was the first distributor for Frigidaire in Southern California. I had all of the counties except Los Angeles County, and I had the east half of Los Angeles County as a distributor for Frigidaire.

I owned the Sierra Madre Electric [178] Company.

I was sole owner of all these companies, sole owner of G. I. Farman Construction Company.

Q. All right, sir, how long did you keep your distributorship of Frigidaire?

A. Until about 1949 when they themselves took over the distribution of Frigidaire throughout the United States.

Q. Until 1949?

A. 1929, I believe. Did I say, '49? I'm sorry.

Q. The Sierra Madre Electric Company, how long did you run that, sir?

A. Until 1930. I sold to Rogers Brothers.

Q. Could you give us an approximation of what that business was worth at that time?

A. At the time of the sale?

Q. Yes, sir.

A. Sierra Madre Electric Company——

(Testimony of Gerald I. Farman.)

Mr. Hall: Your Honor, I do not see the relevancy of this.

The Witness: I don't recall what it is. I would have to remember the indebtedness, the assets and liabilities. I couldn't remember it.

Q. (By Mr. Gardner): What about the G. I. Farman Construction Company?

A. G. I. Farman Construction Company was closed because of the depression. [179]

Q. 1929? A. 1930.

Q. Then in 1930 what did you do, sir?

A. I was unemployed.

Q. How long, sir? A. Oh, about a year. I took, had various odd jobs, but no steady employment.

Q. When did you finally obtain steady employment?

A. In 1932 Col. Edward Glavis, whom I had known and served under World War I, came out to Los Angeles and called me up and said he was in charge of setting up a division of investigations of the Federal moneys being spent throughout the United States, and asked me to head up this investigation of this body that he wanted to set up here, and I took the job.

Q. By meaning head up, that sounds very impressive. Just what did your duties entail?

A. I was a special agent engineer.

Q. You had no engineering degree, however, you stated, did you?

A. No, but I followed engineering all these years.

(Testimony of Gerald I. Farman.)

Q. You were special agent engineer. Just what did you head up, sir?

A. The division, not bureau, the division of [180] investigations of Southern California.

Now, this money, I believe, in fact I know, was appropriated under the PWA Act. The first moneys, as I recall it, were CWA moneys, and then PWA and then there was also another branch WPA.

Q. How many men did you have under you?

A. There were five men in the group. I was considered the group leader.

Q. You were considered the group leader; did you get more pay than the other men?

A. I believe I did. I got $3,600 a year and they got $3,200 a year.

Q. That was in 1932?

A. Yes, 1932, the best of my recollection. It might have been the latter part of '31.

Q. Now, then, how long did you keep this job?

A. I'm afraid I can't tell you. I was probably here in Southern California, was transferred to Washington, D. C., under Col. Fleming, who was chief engineer of the PWA division, as his personal investigator.

Now that could have happened in probably '33, sometime during the year '33.

Q. What was your salary at that time?

A. I know I got an increase in salary, Mr. Gardner. I wouldn't want to say. I don't remember, actually. [181]

(Testimony of Gerald I. Farman.)

Q. 1934, did you continue working as a special investigator?

A. I continued under Col. Fleming until the early part of 1935.

Q. In 1935 what did you do, sir?

A. I would like to cut through this; in the Army and Navy magazine I saw that Col. Donald Connelly had been transferred to Los Angeles. Col. Donald Connelly was an Army engineer and I had served under Col. Connelly at one time when he was a Major, and asked Col. Fleming to transfer me back home, this being my home, and I was transferred, and that was my entry into the position that Mr. Hall brought up in 1935.

Q. Do I understand correctly, sir, that from 1933 to 1935 you were in Washington, D.C.; that was your post of duty?

A. That was my headquarters. However, I covered about 18,000 miles a month, believe it or not.

Q. In other words, your headquarters, your base, was in Washington, D.C.?

A. That's right. That's right.

Q. Where did you consider your home at that time, sir?

A. My home is Southern California.

Q. Still in Southern California? [182]

A. That's correct.

Q. Now we are in 1935 and you are taking over this other job. How long did you keep that job?

A. Until the Army engineers, the staff of Army

(Testimony of Gerald I. Farman.)

engineers assigned to Southern California were transferred out a year, and that was the latter part of 1939.

Q. During this period I believe you have testified that you were chief of the WPA for Southern California?

A. Chief of operations, sir.

Q. Chief of operations? A. I was not——

Q. What was your salary—excuse me?

A. I said that was not a political job. I was under the Army engineers.

Q. I don't mean to make any implications.

A. That's all right, I'm sorry.

Q. What was your salary, sir?

A. Well, it would be a mere guess. I would say $750 a month.

Q. $750 a month?

A. Yes. Biggest job in Southern California. The biggest job I ever had and the biggest job I ever expect to have, sir.

I can't say definitely for the record that I went in at that. I can definitely say I went in at $550 a month. [183]

Q. You went in at $550 a month?

A. I can say for the record that I was supposed to be the highest paid civilian on the Pacific Coast. [184]

* * *

Q. (By Mr. Gardner): Mr. Farman, as we concluded yesterday, we were discussing your job with

(Testimony of Gerald I. Farman.)

the WPA, or some branch of that agent, in 1935 to 1939; is that correct, sir?

A. That is correct.

Q. I believe that the salary you stated that you drew from this position was $550 a month to begin with, may have gone as high as $750 a month?

A. I don't recall how high it went, Mr. Gardner. I was transferred from one agency to another, and I recall that my salary was $550 when I was——

Q. $550 a month?

A. That is what I recall.

Q. Did you have a civil service rating?

A. I have.

Q. What was your rating in civil service?

Mr. Hall: At that time?

Q. (By Mr. Gardner): At that time.

A. I didn't have a rating at that time. That was why I hesitated. I did not have a rating at that time. [187]

Q. You did not have a rating?

A. Not at that time.

Q. Now, just what exactly was the title of this position that paid $550 a month?

A. Director of operation, Southern California.

Q. This was a WPA project?

A. This was WPA, operated as a separate district by the Army Engineers at the request of the President of the United States.

Q. All right. Now, you were known as director of what, sir?

A. Operations.

(Testimony of Gerald I. Farman.)

Q. Who did you report to?

A. To Col. Donald H. Conley.

Q. Do you know how much Col. Conley was making then?

Mr. Hall: I object your Honor, on the ground——

The Witness: I wouldn't know.

Mr. Hall: ——immaterial and remote to the issues of this case.

Mr. Gardner: If the Court please, this is a rather difficult thing to do, to run down the salaries that were being made at that time.

Now, it is the Respondent's position that this testimony is, at least as to salaries, is rather inflated to show a background here, $550 a month in the year 1935. [188] We have made every effort to track this down, and we are still making an effort. It is extremely high; it is more than the Colonel was making.

The Congressmen at that time were making only $10,000 a year. The Governor of this state was making only $10,000. And this is a WPA project.

We seriously doubt the truth of that statement, and we are doing what we can to run it down and attempt to discredit it.

Mr. Hall: Well, to discredit it, your Honor, if that is the attempt, I don't see that Mr. Gardner is attempting to say that Mr. Farman did not hold these positions. What a person was paid as a salary 20 years ago, or more, certainly is something that is easily forgotten.

(Testimony of Gerald I. Farman.)

In fact, I don't see that the question of salary has any bearing on this case at all.

The Court: Well, the pending question has to do with the salary of the Colonel, to whom this witness reported.

Mr. Hall: Yes.

The Court: I think that is getting pretty remote.

Mr. Gardner: Yes, sir.

Q. (By Mr. Gardner): Now, Mr. Farman, let's go back to the year 1931. I believe you testified that Bob Smith, that is, Horace O. Smith, Jr., lived with you; is that correct, sir? [189]

A. When we was first married; yes, sir.

Q. When you were first married.

Mr. Hall: When who was first married?

The Witness: When Mrs. Farman and I were first married, August 19——

Q. (By Mr. Gardner): That is Bob's mother?

A. Yes.

Q. Formerly Mrs. Horace O. Smith; is that correct, sir? A. That is right.

Q. Now, where did you live after you were married, sir?

A. In Mrs. Smith's mother's home in Sierra Madre.

Q. Is that where Bob lived with you, sir?

A. Yes.

Q. Had that been Bob's home all his life?

A. Yes. Not all his life.

Q. Practically all his life? A. Practically.

Q. That is where he grew up?

(Testimony of Gerald I. Farman.)

A. That is right, from 1921.

Q. How old was he, about 17, at that time?

A. I said that was my recollection.

Q. So he was just living where he had always lived; [190] isn't that right?

A. That is right.

Q. Now, did you ever, during the period that you were unemployed, that is sometime in 1931, did you ever make any attempt to get a job with Schalk Chemical?

A. I don't recall it, sir.

Q. All right. During the period 1931 to 1935, did you attempt to get a job with Schalk Chemical?

A. Not to my recollection.

Q. You would remember, if you did, wouldn't you, sir?

A. Not necessarily; that is a long time ago.

Q. During the period 1935 to 1940, did you attempt to gain employment with the Schalk Chemical Company?

A. Not to my recollection.

Q. It is possible that you did, though, isn't it?

A. What is?

Q. It is possible that you did attempt to get a job at Schalk Chemical, isn't it?

A. That last term, '35 to '40, it is not possible.

Q. It is not possible?

A. I had a very good job and I was very interested in my work.

Q. I see. Now, from 1940 to 1945, did you at-

(Testimony of Gerald I. Farman.)

tempt to get a job with Schalk Chemical [191] Company? A. Not to my recollection.

Q. Not to your recollection. It is possible that you did attempt to get a job there?

A. I would seriously doubt it, because I was stationed in San Francisco during that period.

Q. Did you write letters to Schalk Chemical?

A. No doubt I did. I have no recollection.

Q. Did you ever seek employment?

A. Not to my knowledge.

Q. Not to your knowledge. Now, is it your testimony, sir, that to your knowledge you never sought employment with Schalk Chemical Company from 1931 through 1945?

A. I never sought employment with Schalk Chemical on my own during any period.

Q. Well now, would you explain that statement, sir? I would like to have that explained.

A. I married Mrs. Farman in 1931; I believe I am a dutiful loyal husband, and it was my duty to do everything in my power to preserve Mrs. Farman's financial status, her ability to retain what was rightfully hers.

If she asked me to go into Schalk, I think that was a matter of her personal request. It was not a request from me.

Q. What would you do when you went into Schalk?

A. I was asked to go in by Mrs. Farman and her two [192] daughters.

(Testimony of Gerald I. Farman.)

Q. Now, these two daughters, in 1931, how old were the two daughters?

Mr. Hall: What year?

Mr. Gardner: 1931.

The Witness: I don't know. Pat was quite young; Evelyn, as you know her in the books, is one year older than Bob. She was probably 18. Pat was quite young, probably 8, 7, or 8. That is as close as I can give you [193]

* * *

Mr. Gardner: All right.

Q. (By Mr. Gardner): Let's go on then, Mr. Farman. During the period 1931 to 1935, do you recall contacting Schalk Company in any way?

A. Contacting them? [194]

Q. Yes.

A. Well, I don't recall any specific instance of contacting them, but as the husband of the principal owner of Schalk, I naturally was in constant touch with the company's progress and so forth.

Q. You were? A. Yes.

Q. That is 1931 to 1935. Now, you were looking after Mrs. Farman's interests? A. I was.

Q. And during that period, does that now help you to refresh your recollection as to whether or not you sought employment with Schalk?

A. I didn't personally seek employment with Schalk. Mr. Colyear was the president and supervisor of the trust, and I never asked Mr. Colyear, to my knowledge, for a job. My wife might have;

(Testimony of Gerald I. Farman.)

she did; Bob Smith, she asked Mr. Colyear to employ him.

Q. Well, would you wife make such a request with your knowledge?

A. With my knowledge?

Q. Yes.

A. She would, or without my knowledge. I don't recall any instant.

Q. Would you like to have gone to work for Schalk [195] during that period, sir?

A. Not under the trust, no, I wouldn't.

Q. You didn't want to go to work for Schalk under the trust? A. No.

Q. What changed your mind in 1956?

A. I was asked to go to work for Schalk in August, 1946.

Q. Who asked you?

A. Mrs. Farman and the two daughters.

Q. Did she ask you in 1935?

A. Not to my knowledge.

Q. That changed your mind completely in 1946, mere fact that they asked you?

A. I call it being drafted.

Q. You call it being drafted? A. Yes.

Q. I see. Now, let's go back to that job you had with the army. What was that now, during 1942, 1943, what was that job, sir?

A. It was from August, 1940 through 1945, sir.

Q. Through 1945? A. Chief of supply.

Q. Chief of supply. I believe you testified that that was a permanent job, did you not, sir? [196]

(Testimony of Gerald I. Farman.)

A. I testified it was a civil service job.

Q. Civil service job. And did that job cease to exist in 1946? A. Not to my knowledge.

Q. It did not. Who holds that job today, sir?

A. I don't know.

Q. You know that job doesn't even exist, don't you?

A. No, I don't know that it doesn't exist. I haven't been in touch with the Army Engineers since 1945 when I left there.

Q. Well now, you testified that you could have still kept working, didn't you, sir?

A. I did. I assumed I could under civil service.

Q. They don't ever lay off civil service employees? A. They do.

Q. They do?

A. But not usually a good employee.

Q. Not usually a good employee?

A. That is right.

Q. Supposing the job just ceases to exist?

A. Often they transfer them.

Q. They transfer. I believe you did state that near the end of the war the position that you held you weren't very busy? A. That is true. [197]

Q. Because the reason for that position to exist was now going out of business; is that right?

A. It was supply. No, it isn't right it was going out of business, not to my knowledge. It just, the purchasing dwindled down as the war was ending, and there was certainly no indication to me that the job was going to be discontinued in any way.

(Testimony of Gerald I. Farman.)

Q. There was no indication to you?

A. Not at all.

Q. That this job was going to go on through peace time like a big war: is that right, sir?

A. I can absolutely say that to my knowledge they still have a supply department down here at this engineer office, which was, came under my supervision at that time.

Q. How much did you state you were making?

A. I didn't state.

Q. What did you state, sir; would you state, sir?

A. I stated that my classification was principal engineer.

Q. Principal engineer. And how much were you making, sir?

A. I don't know. Principal engineer classification is a matter of available to anybody that wants to go find out?

Q. Did it have a P rating?

A. Yes. [198]

Q. What was the P rating?

A. I don't know, P1, P2, 3 or 4. I don't know.

Q. Could it be as much as $300 a month?

A. It was more than $300 a month.

Q. It was more than $300 a month.

Now, how did you first become employed with Schalk Chemical Company?

A. How did I first become employed in September, 1945?

Q. Yes, sir.

A. I was asked first by Mrs. Farman to see if we

(Testimony of Gerald I. Farman.)

could not arrive at a satisfactory agreement, and cut out, or eliminate the strife, the antagonism, and so forth. And I believe that I suggested to Mr. Smith, and the executive committee, I believe I did —I am not sure—and I do believe that Mr. Smith asked if I would serve on that committee, and if he did, my answer was yes, because I did serve on it.

Q. That was in 1945, wasn't it, sir?

A. That was in 1945.

Q. What was your salary with the——

A. Again, I believe it was $450. I can look it up.

The Court: Salary with whom? [199]

Q. (By Mr. Gardner): With Schalk Chemical?

A. Schalk. I believe it was $450.

Q. $450. How much was the president making, Mr. Farman? A. I do not know.

Q. Could it be the president was making about $300? A. I don't know.

Q. You don't know very much about salaries, do you, for an executive?

A. No. I don't remember back 20 years. In fact, I have——

Q. This is the period——

A. I have the future to look to, and not the past.

Mr. Gardner: I see.

I would like to have this marked as Respondent's next in order, please.

The Clerk: Respondent's Exhibit I for identification.

(The document above referred to was marked Respondent's Exhibit I for identification.)

(Testimony of Gerald I. Farman.)

Q. (By Mr. Gardner): Mr. Farman, I hand you what has been marked Respondent's Exhibit I for identification. The heading at the top of that document is chronological classification account pay schedules. [200]

Now, would you examine that document, sir, and see whether or not you can now tell me what you were making in 1942, '3 and '4?

Mr. Hall: Your Honor, I object to the question, on the ground that the document which Mr. Gardner has put before the witness is dated July, 1951.

Mr. Gardner: If the Court please, may I clarify that?

It shows as each account comes in, your Honor, 1928, 1930, '42, on the far side of the document. It shows the classification and pay of those dates.

Mr. Hall: Your Honor, this is apparently a Government schedule which Mr. Gardner is asking Mr. Farman to interpret. It is dated as of July, '51. It has a lot of footnotes to it, to be sure to refer to accounts earlier. I think it is an unfair question, in the first place, in that the question based upon it, and based upon a schedule which is dated July, 1951, is an improper question to this witness.

The Court: May I see the schedule?

The Witness: Yes. Excuse me, sir.

The Court: It is possible that the schedule may stimulate the witness' recollection, and if it does, the witness may answer.

The Witness: I already stated, your Honor, that I do not know what classification, in the professional

(Testimony of Gerald I. Farman.)

class that [201] principal engineer is; I recall the word principal engineer.

Q. (By Mr. Gardner): I see, sir.

A. And I would have to know what class it is, plus the fact that there were extras during the war, over and above your base pay.

Q. There were extras over and above?

A. I received extras, myself, over and above base pay.

Q. I see, sir; but this does not help you in any way?

A. I don't know what classification. I stated that before, Mr. Gardner.

Q. I see.

A. I don't know whether it is P4, P5, P1, P2. I don't know. If I knew, I would state quickly.

Mr. Gardner: If the Court please, at this time I would like to offer this document in evidence to show——

Mr. Hall: I object.

Mr. Gardner: ——to show, if the Court please, the prevailing salaries during these periods testified to by this witness.

Now, I do that for this reason, too, your Honor, the Petitioners are making an attempt here to set up this witness as a fine executive, and a man accustomed to very important positions, so that when he comes into the Schalk [202] picture, here is an expert now finding fault, if you might, with the management of Schalk.

As a natural matter of fact, there is nothing in his

(Testimony of Gerald I. Farman.)

background to show that he is a businessman at all, an engineer, maybe, yes, but not a businessman. And these fantastic salaries that he has testified to, $550 to $750 in 1935 WPA, is just almost beyond reason.

Mr. Hall: I object to the offer in evidence of that document, your Honor, on the ground that it is immaterial to the issues in this case. It is a remote issue. The witness testified as to his best recollection.

The question of how much he was paid has nothing to do with the point that Mr. Gardner is attempting to pursue. He has not asked him what his duties were, or his qualifications were in that, in those various jobs, and what he was paid is completely beside the point.

The Court: The exhibit is not very helpful, because it is geared to classifications and this witness' classification has not been established. However, I will let it in for whatever it may be worth. As it stands now, it will be of very little aid to the Court.

The Clerk: Exhibit I.

(The document previously marked for identification as Respondent's Exhibit I was received in evidence.) [203]

Q. (By Mr. Gardner): Now, we are up to a time when you first gained employment with Schalk Chemical Company. That is in September of 1945; is that correct, sir? A. Yes, sir.

Q. What was your job at that time?

(Testimony of Gerald I. Farman.)

A. Expediter.

Q. Expediter.

The Court: I might inquire of counsel, in connection with Exhibit I, whether or not the data appearing hereon couldn't be found in the statutes of the United States in any event?

Mr. Gardner: Yes, they can, your Honor.

The Court: So that it is a matter of public knowledge.

Mr. Gardner: It is a matter of public knowledge, but I would just like to have it here for the purpose of bringing it in one document, your Honor. That is, it is my understanding that is public knowledge.

Q. (By Mr. Gardner): All right, sir, we are back to 1945, again, September. You stated you were an expediter? A. That is right.

Q. Now, just what was your job as expediter, sir?

A. To obtain materials for the production in Chicago, mainly.

Q. In Chicago? [204]

A. Mainly, not all. I said mainly Chicago, not always Chicago.

Q. Mainly. Now, you testified, I believe, sir, that you did go to Chicago; is that correct, sir?

A. That is correct.

Q. You testified you went there with Mr. Smith?

A. That is correct.

Q. Now, how long did Mr. Smith stay in Chicago on that trip?

(Testimony of Gerald I. Farman.)

A. Well, I wouldn't recall; probably, I would guess two weeks.

Q. Two weeks?

A. I don't know; I am just guessing.

Q. How long did you stay?

A. Frankly, I don't recall.

Q. This was——

A. That is a very hard thing to remember, details like that.

Q. Well, you couldn't get all of these new sources of supply just overnight, could you?

A. I went to New York from Chicago, Mr. Gardner. I testified to that.

Q. Surely. And you did obtain new sources of supply, didn't you, sir?

A. I did, yes. [205]

Q. That was just your job, wasn't it?

A. That was just my job.

Q. You wouldn't do anything else that anybody else wouldn't do?

A. I had done something that no one else had done.

Q. Had there been an expediter before?

A. They had managers, three of them.

Q. Had they had expediters?

A. I don't think so.

Q. That is why they hired you?

A. They hired me, yes.

Q. Sure. So all you were doing was doing your job, isn't that right?

A. I was doing what my wife—for my wife, yes.

(Testimony of Gerald I. Farman.)

Q. And who was getting the pay?

A. My wife.

Q. Your wife would pick up your pay check, sir? A. Yes, sir.

Q. I see. Does she maintain a separate bank account? A. She does.

Q. And you can't lay your hands on it, sir?

A. I don't want to.

Q. You didn't answer my question.

A. I can't lay my hands on her bank account.

Q. Right. [206]

A. I don't know the legal status of my—I am not interested in laying my hands on her bank account.

Q. Now, it is your testimony, sir, that your wife picks up your salary check from Schalk, and puts it in her bank account?

A. May I—is this all right, Mr. Hall? I don't know. I would say it is my personal business; nothing to do with this unless the Judge wants me to answer.

Q. Well, I want you to answer.

A. I said that I had not accepted a check from Schalk. That is the answer.

Q. Where did the check go?

A. To Mrs. Farman.

Q. You have never accepted anything from Schalk?

A. From or up to now, is this your question?

Q. Up to now.

A. It is absolutely right. I never have taken a

(Testimony of Gerald I. Farman.)

nickel from the Schalk Chemical Company up to now. I endorse my checks over to Mrs. Farman. It is her company and her business.

Q. Do you have a bank account, Mr. Farman?

A. I do.

Q. Where do you get the funds that go into your bank account?

A. I think that is personal. [207]

Q. Yes, it is. Let's find out, where do you get the funds?

A. It is personal. I refuse to answer.

Mr. Hall: I object on the ground that Mr. Farman's income from private sources is not an issue in this case. If he has such income, that is his personal business. I don't see that it has anything to do with this case. It is immaterial, incompetent and irrelevant.

The Court: Mr. Gardner.

Mr. Gardner: Well, if the Court please, I am rather startled by the testimony of the witness to say the least. Apparently here is a man with wings, an angel no doubt. He works hard; he gets absolutely nothing out of it. Yet, he must have some funds.

Now, where does he get these funds? He didn't have in 1935, he didn't have them when he was broke in 1931.

The Witness: Did you establish——

Mr. Gardner: I don't know——

Mr. Hall: Your Honor——

Mr. Gardner: How he is doing this, or, and I do want to get into it. I would like to find out what

(Testimony of Gerald I. Farman.)

this wonderful source of supply he has of funds.

Mr. Hall: Your Honor, the arrangements personally between Mr. and Mrs. Farman, as to what they do with their [208] income, whatever it may come from, is of no concern to this case. It is immaterial, and has nothing to do with the issues that are involved here.

The Court: Well, one of the central issues in the present case goes to the controversy which is alleged to have persisted with respect to the Schalk Chemical Company, and this witness has—and this witness' testimony that he never took any money from the Schalk Chemical Company, notwithstanding his rendition of services, is rather surprising, and I think Counsel is entitled to pursue the implications of that.

Mr. Hall: Well, your Honor, it has nothing to do with the controversy. The controversy that has been discussed is between the management of Schalk during the period, the management composed of Mr. Smith and the persons whom he had designated, and the rest of the family; those two groups, if you please.

The Court: Well, it goes to the relationship of this Petitioner with Schalk; it goes to the accuracy of his testimony that he has never taken anything from Schalk.

Mr. Hall: Well, your Honor——

The Court: And I rule that the witness may answer.

Mr. Hall: Thank you.

(Testimony of Gerald I. Farman.)

The Witness: I have a personal income, a small income that takes care of my needs. [209]

Q. (By Mr. Gardner): All right, sir. How small is this income?

A. It is less than $300 a month.

Q. Less than $300 a month? A. Yes, it is.

Q. And this is only money that you use, $300 a month; is that right, sir?

A. That is correct, yes.

Q. And——

A. I am not talking about principal, I am talking about my income, interest income.

Q. What is the source of the $300 a month, sir? A. Private.

Q. All right, private. Private what?

A. I have some money out at interest.

Q. How much money, sir?

A. I don't know why I have to answer these questions.

Mr. Hall: Your Honor, I would like to object again. It is completely beyond the issues of this case; it is immaterial, unrelated. It is argumentative to quite a degree.

The source and how much money Mr. Farman has invested somewhere, and where he has it invested, is immaterial to the issues of this case, your Honor.

I might state that Mr. Farman said he didn't [210] take anything from Schalk Chemical Company. He later said that he endorsed the checks, I mean, it is a matter of language.

(Testimony of Gerald I. Farman.)

The Court: I interpret his testimony to mean that he did not benefit financially. The situation seems rather surprising. I don't know whether the matter will ultimately turn out to be relevant or not. At the present time, it is potentially relevant.

If it should turn out not to be, I shall entertain a motion to strike.

Mr. Gardner: Would you read the last question?

(Question read.)

The Witness: This was out at interest, is this what you are——

Q. (By Mr. Gardner): Yes. I was referring to it, you testified, I believe, that you have approximately $300 a month income from an investment, interest income.

The Court: Would you fix the date, Mr. Gardner?

Q. (By Mr. Gardner): That is as of what date, sir?

A. I would assume today is what you are talking about.

Q. All right. Today, sir. And in fact, going back to 1945, how much interest income did you have, or what was [211] your source of income?

A. Mr. Gardner, that, my income has varied during this period. It has been high at some times, and practically nill at others.

Q. In 1945, what was your income from this source? What I am trying to find out, Mr. Farman, is what is the source of this income?

(Testimony of Gerald I. Farman.)

Do you have a large amount of cash on hand that you invest, or what?

A. I had investments of various kinds. I have sold my investments, from time to time, stock, for instance.

Q. Stock?

A. Now, if you would like to know the names of the companies, I am afraid that I would have to go back to my records with McKesson-Thompson and Company, who handle my account, and find out; the last was a Canadian stock that I invested in, and I sold it at a profit.

Q. I see.

A. And I have investments of $5,000, investment in a mortgage for instance, right at the moment. I have not a big income, as you see, and they are all from small investments.

Q. You have small investments that bring you in approximately $300 a month as of today?

A. No. I said less than $300 a month. [212]

Q. Less than $300 as of today?

A. As of today.

Q. And this income is from investments such as $5,000 mortgage?

A. Stock investments, and small stock investments.

Q. Stock investments. Did you have this nut, or this principal sum that you are now using to invest in mortgages and various stocks that you have, did you have that amount back in 1945?

A. To say that I had the exact amount that I

(Testimony of Gerald I. Farman.)

have today, I would not be able to answer. I had some money back in 1945.

Q. You had some money. Did you have as much in 1945, as you have today?

A. I own stocks in 1945.

Q. Just answer the question.

A. No, I can't answer.

Q. Do you have more today than you had back there then?

A. I don't think I did, no. I think I had more back there than I have today.

Q. You have lost money on your investments then? A. No, I haven't.

Q. What has happened to them; why have they been reduced then? [213]

A. I was receiving my pay in 1945 from the Government, that I kept myself, or helped to support the family with it, in 1945. You mentioned 1945?

Q. Yes.

A. And I had that income, whatever it was, as a principal engineer.

Q. What happened to your investments, if they went down?

A. I didn't say my investments went down. I said I do not recall whether, on a balance sheet, I had as much in 1945 as I have today, or less. Or less, I have no idea. I would have to go figure it out.

Q. Your testimony, as I understand it, is now that the sole income that you have had from 1945

(Testimony of Gerald I. Farman.)

to 1958, results from your investments, and is now approximately $300 a month; is that correct, sir?

A. It is not exactly correct, and that was not my testimony.

Q. All right. Let's straighten it out. What was your testimony?

A. I said from 19—during 1945, '46 and I will add '47, if you wish, my income was not of a steady nature. I made money at one time, and maybe there was a lull in between. From 1948, January, 1948, to 19—to date, I stated that I have endorsed the checks that I receive as [214] president of the company over to my wife, and that I have my own independent income, which is less than $300 a month.

Is that clear?

Q. No, it is not exactly clear. I understood that you did that from 1945 on.

A. No. I didn't say from 1945. I said that during 1945 the checks that I received from Schalk were endorsed to my wife.

Q. All right.

A. That is what I stated.

Q. Did she get the proceeds from that check?

A. Yes.

Q. Well, how did that differ from what is going on in 1948; isn't that exactly the same process you are going through now?

A. It didn't differ from 1948, but there has been a lapsed period in there that you have incorporated, which I refuse to have in there, as 1947.

(Testimony of Gerald I. Farman.)

Q. All right. In 1946, did you do the same thing with the checks?

A. I did, to my best recollection, yes.

Q. That is, you received absolutely nothing from Schalk, yourself?

A. I don't say—I said to my best recollection, in 1946, I did. [215]

Q. Well now, did you or didn't you?

A. I don't know. I said, to my best recollection I did.

Q. You did what?

A. I endorsed the checks over to Mrs. Farman.

Q. That includes your salary check?

A. My salary checks is what I am talking about.

Q. I see. Did you ever get any proceeds for being, during one period there I believe you were vice president of the corporation, were you not, sir?

A. In 1946, during—I don't know from February on I think.

Q. You voted yourself a bonus of $1200 during that year, didn't you, sir?

A. If I did, it is a matter of record. I didn't vote myself that. I couldn't vote myself that.

Q. Didn't you?

A. The directors should vote a bonus to employees, I believe.

Q. Didn't you offer the resolution?

A. I may have, yes. I don't recall it. It is a matter of record.

Q. Now, going back to 1931 again, now, we are going to cover the management of Schalk Company.

(Testimony of Gerald I. Farman.)

From 1931 to 1942, who was the president and supervisor? [216] A. C. C. Colyear.

Q. C. C. Colyear? A. Yes.

Q. What sort of an individual was Mr. Colyear, as far as you know, sir?

A. He was a businessman. He had a chain of automotive, I guess you would say automotive part stores on the West Coast.

Q. Was he a good businessman, sir, in your opinion?

A. Why I would say a man that had built up a chain of stores would be considered a good businessman, in my judgment.

Q. Now, he managed Schalk from 1931 to 1942; is that correct, sir?

A. Up to the time of his death, I believe, or just prior to his death, he resigned.

Q. And this includes that period that had you so worried; that is 1939, doesn't it, sir? I believe you testified——

Mr. Hall: Your Honor——

Mr. Gardner: To refresh your recollection, that it was your opinion that the company was on the skids in 1939?

The Witness: That is correct.

Q. (By Mr. Gardner): All right, sir. Now, this is the same man, [217] Mr. Colyear?

A. Yes, sir.

Q. Good businessman? A. That is right.

Q. That was running the company at that time; is that correct, sir?

(Testimony of Gerald I. Farman.)

A. That is correct. He was running the company at that time.

Q. Yet, according to you, it was next door to bankruptcy?

A. I didn't say it was next door to bankruptcy. I stated the company and stated figures to back me up, the products produced by the company were on the downgrade in 1939. I can't recall my words, but——

Q. That was at a time when the management of that business was in the hands of a good businessman; isn't that correct, sir?

A. I wouldn't say it was correct, sir.

Q. What would you say was correct?

A. I would say that Mr. Colyear, this is hearsay evidence, that Mr. Colyear never, at any time, was in the Chicago plant during the time of his regime as president of the company, and supervisor of the trust.

I would say that he paid very little attention to the Schalk Chemical Company in any way, shape or form. [218] It was a trust and it was, he held it intact.

Q. I see. Are you finished? A. Yes.

Q. I am sorry I interrupted you, sir.

How many times did you go down and visit Schalk during the period 1931 to 1940, sir?

Mr. Hall: I can't hear you, Mr. Gardner.

Mr. Gardner: Excuse me. I asked how many times he visited the Schalk Company from 1931 to 1940.

(Testimony of Gerald I. Farman.)

The Witness: I would be unable to answer that, Mr. Gardner. I wouldn't even know if I was down there once in that length of time.

Q. (By Mr. Gardner): And you wouldn't even know whether Mr. Colyear was there or not, would you?

A. I did not make my statement as to this plant. I made my statement as hearsay evidence, from the manager in Chicago, that he never, at any time, during his reign as president and supervisor of trust, ever visited the plant in Chicago.

Q. Now, during this period, that is 1931 to 1942, when Mr. Colyear was supervisor, or and president, who was the manager of the Los Angeles plant?

A. I believe Mr. Lieben was.

Q. Mr. Lieben? [219]

A. My understanding, yes.

Q. All right. Then how long had Mr. Lieben been there?

A. I believe he came in as a bookkeeper. In my understanding, he was there in the '20's, when I first met him.

Q. When did you first meet him?

A. I can't tell you the exact date. During the 1920's.

Q. Did you know Horace O. Smith?

A. Very good friend of his, sir.

Q. That is Horace O. Smith, Sr.? A. Sr.

Q. We are talking about? A. Yes.

Q. Horace O. Smith, Sr., apparently employed Mr. Lieben; is that correct, sir?

(Testimony of Gerald I. Farman.)

A. I believe that is correct; I don't know.

Q. And Horace O. Smith, Sr., owned all the stock in Schalk Chemical prior to his death, didn't he, sir?

A. I couldn't answer that. I don't—my recollection, I should be able to remember it, but I don't know. There might have been a small block of outstanding stock. I am not sure.

Q. In any event, under the terms of the will, are [220] you familiar with the will?

A. Yes, sir.

Q. Under the terms of the will he left all the shares of stock to his mother and his three children; didn't he? A. That is right.

Q. He didn't leave any to Mrs. Smith, did he?

A. That is correct; that is correct.

Q. So, he must have had all the, all of the stock at the date of his death?

A. Must have, yes.

Q. And during that period, Mr. Lieben was the supervisor, or wasn't he, or he managed the plant, too, didn't he, under Mr. Horace O. Smith, Sr.?

A. What period?

Q. Under the period prior to Horace Smith, Sr.'s death? A. No, he didn't.

Q. What did he do?

A. He was bookkeeper.

Q. He was bookkeeper? A. Yes.

Q. Who managed the plant, do you know, sir?

A. Jack Williams.

Q. Jack Williams. What happened after Mr.

(Testimony of Gerald I. Farman.)

Smith, Sr. [221] died, as far as Jack Williams was concerned?

A. Mr. Colyear fired Jack Williams, because he was a friend of Mrs. Farman's and was reporting what was going on to Mrs. Farman direct.

Q. So, Mr. Colyear got rid of him?

A. Got rid of him.

Q. He cut out dissension right now, didn't he?

A. No dissension, there was no dissension back at that very time that he was fired.

Q. All right, sir. Now, that means that Mr. Lieben was then put in as supervisor or manager; is that right, sir?

A. Those are your words; I don't know.

Mr. Hall: Your Honor, I object to Mr. Gardner using the word supervisor, or manager, in the manner in which he is doing it, because it is confusing to the witness. Now, we have——

Mr. Gardner: That is well taken.

Mr. Hall: We have a supervisor under the trust. Let's keep the terminology straight.

Mr. Gardner: Very good.

Q. (By Mr. Gardner): It was after Mr. Williams' departure that Mr. Lieben became the manager of the plant in Los Angeles plant? [222]

A. This Los Angeles plant I believe is correct, yes.

Q. Is that right, manager of the plant?

And that would be in approximately 1931; is that correct?

A. No, I don't think it is correct. I don't think

(Testimony of Gerald I. Farman.)

Williams was fired in '31. I think he was fired after that.

Q. '32?

A. I imagine '32 or '33, I have no——

Q. In any event, Mr. Lieben was placed in his position which we will call manager of the Los Angeles plant, by Mr. Colyear who had a fine reputation, I suppose, as a businessman; is that correct, sir?

Mr. Hall: I object to the question on the grounds it is argumentative, limited to the first part of the question.

The Court: Sustained.

Mr. Gardner: All right.

Q. (By Mr. Gardner): He was placed in that position by Mr. Colyear?

Mr. Hall: If you know, Mr. Farman.

The Witness: I don't know that he was.

Q. (By Mr. Gardner): In any event, Mr. Colyear was supervisor at that time? [223]

A. He was supervisor.

Mr. Hall: What year?

Mr. Gardner: Talking about the year Mr. Williams departed. We don't know what year.

Mr. Hall: How can the witness answer the question?

Mr. Gardner: Because he is the one that doesn't know the year. He knows that Mr. Williams left and at the same time Mr. Lieben was placed in as manager.

Mr. Hall: He said he doesn't know.

(Testimony of Gerald I. Farman.)

Mr. Gardner: He said what?

Mr. Hall: He doesn't—said he didn't know.

The Witness: That is correct, I don't know.

Q. (By Mr. Gardner): You don't know that, whether or not Mr. Lieben was placed in the position of manager?

A. After Mr. Williams was fired, I certainly do not know.

Q. Weren't you keeping close touch with Schalk?

Mr. Hall: What year, Mr. Gardner?

Mr. Gardner: When Mr. Williams left. When Mr. Williams left.

Mr. Hall: Well, the witness said he didn't know when Mr. Williams left.

The Court: The question is a proper one. Proceed.

The Witness: I do not know if Mr. Lieben was given [224] the job that Mr. Williams had when Mr. Williams was fired. I do not know. I do know—well, go ahead, go ahead. I am sorry.

Q. (By Mr. Gardner): Do you know whether or not Mr. Lieben was ever——

A. Yes, I do.

Q. Ever what? A. Manager.

Q. Manager of what?

A. Of the Los Angeles plant.

Q. When did you first make that discovery?

A. Well, it was during the period of—well, it was in the 1930's, when Mr. Lieben sent some reports into the directors. I was not a director. I was with Mrs. Farman, who was in very poor health,

(Testimony of Gerald I. Farman.)

and Mrs. Farman's attorney at a director's meeting, and there was a report from Mr. Lieben to Mr. Colyear, and I believe that all it was signed was Lieben. The inference was that he was managing or taking, was manager of the Los Angeles plant.

Q. What year was that, sir?

A. I can't tell you the exact year.

Q. That is the first you knew about it?

A. Well, it occurred several times during the period that Mr. Colyear was president and supervisor of the trust. I would say during the period of 1935, to 1940. [225] I attended several directors' meetings with Mrs. Farman, because of her health.

The Court: When did you first learn of, Mr. Lieben was the manager of the Los Angeles operation?

The Witness: I cannot state the exact date, but I would say in 1934 or 1935.

The Court: Was there a period of several years when you didn't know who was the manager?

The Witness: I believe there was a period of about two years after Mr. Williams was fired, your Honor, that I didn't know who was the manager. I wasn't informed.

Q. (By Mr. Gardner): Now, who was the manager of the Chicago plant, if you know, sir, during the period 1931 to 1945? A. Carl Fulmer.

Q. Carl Fulmer. How long was he manager at that plant, sir, if you know?

A. I don't know, when Schalk first entered the field in Chicago. I don't know the date that they

(Testimony of Gerald I. Farman.)

went into Chicago, and opened a plant, but I believe Mr. Fulmer was with the company from the inception of its entry into Chicago and a little prior to that.

Q. I see. Was he employed under Horace O. Smith, or do you know? A. Yes, he was. [226]

Q. That is Horace O. Smith, Sr.?

A. Sr., that is right.

Q. Yes. And how long, or what year, if you know, did Mr. Fulmer leave the company, or has he left it?

A. To my best recollection, I am not positive of this statement, it was 1949.

Q. When he left the company? A. Yes.

Q. Was he manager of the Chicago plant at that time?

A. No, he was not. He had been transferred to Los Angeles to make a study, a research on market product production. He was quite an artist and he did a lot of very interesting art work for the packaging of Schalk.

Q. I see. When did he cease to be manager of the Chicago plant, sir, if you know?

A. That is a very difficult—it was during the 1948 that I transferred him out here. It would be very difficult to pin down the month, without the record, looking in the record.

Q. He was manager at the Chicago plant at the time you became president of Schalk, in 1948?

A. He was.

(Testimony of Gerald I. Farman.)

Q. One of your first acts was to remove him as manager of that plant; is that correct, sir?

A. I don't think it was one of my first acts. It [227] was in the general reorganization of the company that he was transferred out here.

Q. He was transferred?

A. And he was promoted when he was.

Q. He was promoted? A. Yes; he was.

Q. Was he a good man?

A. Very good man on a lot of his ideas, a world of experience.

Q. All right, sir.

* * *

Q. (By Mr. Gardner): Mr. Farman, when the recess came, I believe we were just finishing with the discussion on Mr. Fulmer. And I would like to get it absolutely clear as to the time during which Mr. Fulmer was manager of the Chicago plant, as far as you know, sir.

A. I first met Mr. Fulmer in 1926 or 1927, in Mr. Smith's home in Sierra Madre. He was manager at that time, and was manager up until the time that I transferred him, either in 1948 or '49, to Los Angeles.

Q. I see, sir, thank you.

Now, there is one other point I would like to get into before we get into further accounts of the corporation, and that is during the time you were chief of Naval [228] supply here. I believe you testified that——

Mr. Hall: Chief of supply, Corps of Engineers,

(Testimony of Gerald I. Farman.)

not Navy supply.

Mr. Gardner: Excuse me, sir.

Q. (By Mr. Gardner): What was your title?

A. I was chief of supply, Corps of Engineers, United States Army.

Q. Oh, United States Army?

A. Yes, sir.

Q. All right, sir. During that time, I believe you testified that you desired to purchase certain materials for Schalk Chemical Company?

A. Yes; right.

Q. And I believe you testified that you were turned down. What was the first occasion that you——

A. The first occasion that I recall, and I can be wrong because I don't recall the sequence, was when we built a house in Modesto, California, and the only flooring I could get was swamp hemlock. It is a part of the details only, and I wanted to bleach that floor and I knew the Double X was a terrific bleach, and I asked, or asked Mrs. Farman and I think I asked Bob later on for a shipment of 10,000.

I recall the amount because it was calculated [229] by the project engineer.

Q. What was the answer that you received, sir?

Mr. Hall: From whom?

The Witness: I was going to ask from whom?

Q. (By Mr. Gardner): What was the answer that you received from Mrs. Farman?

A. When Mrs. Farman told me that she took it up with Bob, and they didn't have the materials,

(Testimony of Gerald I. Farman.)

and I said, well, you explain to Bob that I will issue a priority for the materials.

Q. And then what happened, sir?

Mr. Hall: With regard to that order, Mr. Gardner, is that what you mean?

Mr. Gardner: Yes.

The Witness: Mr. Gardner, I can only answer it this way: That soon after that I made it a personal, I wanted the materials. I was not thinking of Schalk. I made it a personal point on one of my trips to go down and see Lieben and ask him for the materials.

He said he wasn't interested in supplying the Government with any materials, and I recall——

Q. Who is he, sir?

A. I said Mr. Lieben.

Q. Oh, Lieben, excuse me, sir. Mr. Lieben [230] stated what, sir?

A. Mr. Lieben stated that he wasn't interested in supplying the Government, and that he wanted all his, he wanted all of the materials they were able to make to go to consumers.

Q. Now, at that time, do you know whether or not Schalk was having difficulty obtaining employees?

A. Well, the answer to that question, all companies were having difficulty in hiring employees, because they were being drafted as fast as——

Q. So, it was rather a difficult situation?

A. It was, yes, it was; it would be.

Q. Actually, many companies, including Schalk,

(Testimony of Gerald I. Farman.)

could have done a much larger business had they had the employees, couldn't they?

A. Oh, there is no doubt, sir.

Q. Now, the second time that you contacted Schalk, sir, was when?

A. It was shortly, it was during this period, it was shortly after I asked, Mrs. Farman asked Bob for it. At that time, I also saw Bob and told Bob that I needed this material very badly. It was imperative that I get a similar, get this material or similar material, and that I would give him a priority with a ten per cent cushion in it to furnish the material. And he said, well, he wasn't [231] interested in the order.

Q. Now, could the reason, as you well know at that time, there was also difficulty of obtaining employees, wasn't there?

A. Mr. Gardner, that is true. I am going to add something.

Q. That is true? A. If I may——

Q. You may, oh, surely.

A. I may. The formulation of Double X is a very, very simple matter. Mr. Smith was working in the factory, himself, most of the time, I believe, and Mr. Smith could have easily formulated the amount that I wanted in a very short period of time. It was bulk material that I wanted.

Q. I see. But supposing the plant was operating at capacity, that is Mr. Smith himself, the president was working in the plant, that should indicate to you that they were using their manpower to the ultimate, wouldn't it?

(Testimony of Gerald I. Farman.)

A. Not necessarily, no. Mr. Smith enjoyed the factory arrangement; told me he did.

Q. But, in any event, the president was actually working in the plant during this time; wasn't he?

A. He was from time to time.

Mr. Hall: During what time, Mr. Gardner?

Mr. Gardner: If you will keep current with the [232] questions, sir, you will know this is the time that he, that the witness was ordering or attempting to order supplies from Schalk for his—what was that, the Army, you say, Mr. Witness?

The Witness: The Corps of Engineers, United States Army, War Department.

Q. (By Mr. Gardner): All right, sir. Now, then, we will get into the corporation.

Do you know, or do you recall whether or not dividends were declared in the year 1942, sir?

A. I could not recall definitely that they were. They were declared, I believe, under the trust agreement. I believe there was. There is a stipulation that they would declare dividends whenever possible.

Q. Well, now, do you know whether that was carried out during 1942?

A. I can't specifically say. I didn't receive the dividend, so I couldn't specifically say.

Q. Were you present?

A. I have records of those. If I could bring my records up, I have records of all the dividends paid.

Mr. Hall: Your Honor, we have them. Mr. Gardner has in evidence the audit reports from

(Testimony of Gerald I. Farman.)

1942 to 1946; also Petitioners have in evidence the audit report of 1947, [233] which reports show whether there were or were not dividends.

Mr. Gardner: May I have the reports, your Honor?

Q. (By Mr. Gardner): In order to save time, Mr. Farman, I will read to you from these exhibits the dividends declared as to each of the years.

Mr. Hall: Your Honor, would Counsel please state the reason for reading from the exhibits which are in evidence?

Mr. Gardner: This is for the purpose, your Honor, for further questions of this witness.

Mr. Hall: Regarding dividends?

Mr. Gardner: Regarding dividends; yes, sir.

Q. (By Mr. Gardner): Exhibit D, for the year 1942, shows dividend paid of $10,000.

Exhibit E, for the year 1943, audit report shows dividends of $17,500.

Exhibit F, audit report for the year 1944, shows dividends declared of $15,000.

Exhibit G, audit report for 1945, shows dividends declared of $15,000.

Exhibit H, audit report for 1946, shows dividends declared of $57,000.

Now, when you first came to the Schalk Chemical Company in 1945, I believe you stated you were expediter? [234] A. That is correct.

Q. And were you also a member of the board of directors? A. No, not in 1945.

(Testimony of Gerald I. Farman.)

Q. I see. Did you subsequently become a member? A. I did, in 1946.

Q. In 1946. Now——

Mr. Hall: Your Honor, it is stipulated by the Government that he became a director in '45.

The Witness: I am sorry.

Mr. Hall: I believe Mr. Farman is just mixed up.

Mr. Gardner: I make no issue of that.

The Witness: I will assure you I didn't recall it.

Q. (By Mr. Gardner): I made no effort to trap you, or anything like that. If it was 1945, the record will show that. I realize that was some time back, sir.

Now, I wasn't quite sure from your testimony as to just when you became alarmed at the management of the corporation. Could you tell me when that was, sir?

A. I would like to ask you which management of the corporation, the Smith management, or the Colyear management?

Q. All right, sir. Let's go back to the very beginning then, sir; when did you first become alarmed [235] at the management of Schalk Chemical Company?

A. In 1931, when I married Mrs. Farman, soon after that.

Q. You became alarmed? A. I did.

Q. Would you tell the Court your reason for being alarmed, sir?

(Testimony of Gerald I. Farman.)

A. Mr. Colyear presented to Mrs. Farman, in my presence, an employment contract, which in my —to my best judgment was the most absurd thing that could be asked of a company.

It required, it demanded a salary and——

Q. Excuse me, sir.

A. The employment contract incorporated a salary and a percentage of the profit.

Q. To whom was the employment contract?

A. With the Schalk Chemical Company.

Q. Who was to be employed?

A. Mr. Colyear's contract. I am sorry, I didn't make that clear.

Q. Mr. Colyear's. All right, sir.

A. It was quite alarming.

Q. It was quite alarming to you, sir?

A. Yes, sir.

Q. All right. What else? [236]

A. Well, during the years from '31 to 1940, the supervision of Schalk Chemical Company by Mr. Colyear was based on an attitude of holding the company, not progressing, but holding it intact, because it being a trust, I believed that his statements were that all I am interested in doing is holding the trust intact, is not advancing the Schalk Chemical Company.

Q. All right, sir. What else alarmed you?

A. Well, as I stated, if I may refer to my book, I could get it correct. I believe it was 1939, a product I mentioned, Hydro Pura, the sale of Hydro Pura at one time when I first knew the Schalk Chemical Company was $270,000.

(Testimony of Gerald I. Farman.)

Sales had dwindled during this period that I will refer to as the '39 period, 1938-39 period, it dwindled down to about $14,000. I have that figure; I quoted out of my notebook.

The main leads in the line, and the big profit item, and the product that was carrying the Schalk Chemical Company was Double X, and I stated in my testimony yesterday, that Double X had slid, was sliding fast, and I also tried to explain that a lot of that was due to the fact that electric sanders were introduced during those periods.

Q. Electric sanders? [237] A. Yes.

Q. Now then, did you ever tell Mr. Colyear you didn't approve of his management?

A. Mr. Colyear, because I was asked by my wife, and would naturally do it when Mr. Colyear presented his contract for employees. I asked Mr. Colyear a very short and pointed question, "Can Schalk stand this type, or this amount of money?" And he immediately became enraged, and walked away.

From then on I didn't see Mr. Colyear up to, for the rest of his life.

Q. You never did see him again?

A. After that.

Q. Did you ever, now that we have talked about this a little bit, did you ever go down and contact anyone at the Schalk Chemical Company?

A. I did. I said up to the time of his death, Mr.——

Q. Yes.

A. I didn't during that time, to my knowledge, no.

(Testimony of Gerald I. Farman.)

Q. In other words, you didn't set foot in Schalk Chemical Company?

A. Not to my knowledge. Mrs. Farman received yearly financial statements. I always studied those with her, explained them to her, as well as I could.

Q. Did you attend the board meetings with her? [238]

A. I did, from time to time, not every time, sir.

Q. Now, where were the board meetings held, sir?

A. In Mr. Wackerbarth's office, here in Los Angeles.

Q. Wackerbarth? A. Wackerbarth.

Q. Was Mr. Colyear present at some of those meetings?

A. That is a hard question for me to answer. He would be present if he was in town. I am sure he wouldn't call a meeting without being present.

Q. You didn't mean that exactly, when you said you didn't see him again?

A. I should retract that statement. I was thinking in terms of going to see Mr. Colyear and not actually the meetings with Mr. Colyear.

Q. At the board meetings, during the period 1931 to 1942, did you take an active part in those meetings, sir? A. I was not a director.

Q. Did you ever say anything in those meetings?

A. It would be very hard to recall, sir.

Q. All right. Now then, we are up to—was there anything else that bothered you about Mr. Col-

(Testimony of Gerald I. Farman.)

year's management with the, of the firm, up to 1942?

A. Well, the principal thing that no new products, research. There were new products introduced during the [239] period, two of them, but no research, no attempt to further Schalk's interest in advancement in the field that they were in, sir.

Q. I see. Now then, I take it we have exhausted your reasons for your dissatisfaction with the management?

A. There is one time in 1940, he was still president, that there was a loss that was of great concern, but it was the pattern, predicted pattern, pattern predicted by me that would happen, that this continued holding the straight line meant deterioration of Schalk. I made that statement many times.

Q. I see. Did you inform your wife of this?

A. I did.

Q. Did she inform Mr. Colyear of this at the board meetings?

A. She did at director's meetings.

Q. She, in effect, told Mr. Colyear what you had told her; is that correct, sir?

A. I believe that is probably correct.

Q. You advised your wife all during the period of the trust; didn't you, sir? A. I did.

Q. But, and she relied on your judgment, didn't she? A. I hope so. [240]

Q. You advised the daughters also, didn't you, sir? A. I did.

Q. And they relied on your judgment?

(Testimony of Gerald I. Farman.)

A. I hope so. I think they did.

Q. Now, does that exhaust the reasons for your dissatisfaction with the management of Schalk up to 1942?

A. Well, I realize that this question is a very pertinent one. I don't recall. It is very hard for me to recall the small or large, or major, the two major things were that Mr. Colyear's statement to Mrs. Farman was that he was not interested in furthering Schalk's advancement, that he was supervisor of the trust, and that all he cared to do was hold the company intact for up until the trust, to the duration of the trust.

Q. I don't want to argue with you, Mr. Farman, but that seems like an extremely stupid statement for a good businessman to make, and I believe you have testified that he was a good businessman.

A. I didn't testify. He had the reputation of being a good businessman.

Q. And he made a stupid statement like that, sir?

A. He made that statement on several occasions.

Q. That he was not interested in——

A. In furthering the advancement of Schalk. He was interested in holding the trust intact, to its duration, which caused the whole family great concern, I will assure [241] you.

Q. I see, sir. Now, going to the management of Schalk for the period 1943 on, until the president and supervisor, Horace Smith, Jr., stepped out in 1948——

(Testimony of Gerald I. Farman.)

Mr. Hall: It is stipulated, Mr. Gardner, that Mr. Smith became president in 1942.

Mr. Gardner: Yes, he became president in '42, became supervisor in '43, did he not?

Mr. Hall: He did. You asked from '43 on. I just wanted to be sure the witness understood your question.

Q. (By Mr. Gardner): My question goes from 1943. A. What is it, end of 1943?

Q. Up until the time that Mr. Smith, Jr., left the corporation? A. Okay.

Q. When did you first become dissatisfied with Horace Smith, Jr.'s, management?

A. Well, I became alarmed during the period that I mentioned, when I couldn't buy war materials that were essential to the war effort from Schalk. I couldn't understand that, and was very alarmed over it, over the thing.

Q. I see, sir. And when next did you become alarmed? [242]

A. Well, when Mr. Smith, Jr.'s, mother offered suggestions for new products, and Mr. Smith refused to accept any of her suggestions, and also offered suggestions in the packaging of our products.

Q. Now, these suggestions were whose suggestions, sir?

A. They were Mrs. Farman's suggestions.

Q. Were they your suggestions to Mrs. Farman?

A. I would say a very small percentage of them

(Testimony of Gerald I. Farman.)

would be my suggestions. I was very busy man, working 18 hours a day, and I didn't have time to fool around with too many suggestions.

Q. I see. Now, at about what year did this occur?

A. Well, you mentioned the years of 1942 through 1947, and I have made that statement in general. That it was during those years, the early part of it was 1943 and 1944, that Mrs. Farman was, started to enter into new product field. I can't strike down a date. I can give you two years.

Q. All right. What were the two years?

A. 1943 and 1944.

Q. All right. Now then, we are up to 1944; in other words, was there anything in 1945 that caused you alarm, sir?

A. Well, the greatest alarm during 1945 was the [243] fact which I testified to, when I was employed in September as an expeditor, and went to Chicago with Mr. Smith, and found that their factory was virtually shut down because of lack of materials.

Q. That is the exact job you were hired to do, wasn't it? A. That is right.

Q. So you were doing nothing more than what you were hired to do? A. That is right.

Q. But you were alarmed then?

A. I was hired for that in 1945, and I was alarmed at that time.

Q. All right, sir. Now, when was the next time you were alarmed?

(Testimony of Gerald I. Farman.)

A. Well, I was alarmed when in 1945 we set up an executive committee, which Mr. Smith proceeded to ignore. This executive committee was set up to manage, and manage the Schalk Chemical Company, and Mr. Smith proceeded, at the very inception of it, of the signing of the agreement to ignore it.

Now, what in management were you dissatisfied with during that period, sir?

A. Lack of research, market research and lack of new product research. [244]

Q. I see. And well—go ahead.

A. There is nothing being done during that period in 1945, that I mentioned, from September towards improving the products. They had a food chemist on a retainer fee at $300 a month that was doing nothing. He was a food chemist, a very fine food chemist, but he was not familiar with the organic chemicals or the chemicals used by Schalk Chemical Company.

He also probably was, in fact, I went over to see him several times. He was supposed to introduce new products, which he didn't do.

Q. What about the financial structure of the company at this time, were you pleased with that, or dissatisfied? A. In 1945?

Q. Yes.

A. That was never a part of the controversy that I recall.

Q. All right, sir. Let's get up to 1946 then.

What about the financial structure of the company at that time: were you satisfied with it?

(Testimony of Gerald I. Farman.)

A. I made a report to the executive committee that the products that we were shipping that we had been able to purchase materials with orders that dated back as far as June, 1945, and I said this 1946 is a very inflated year, it has no, it is no yardstick for measurement at all. [245]

Q. I see. Was it in 1946—I believe you testified it was some time in 1946 which you became quite alarmed, and attempted to at least discuss with Horace Smith, Jr., the possibility of his stepping out as president and supervisor.

A. The fact that Mr. Smith refused to co-operate in any way with the family, the family being Mrs. Farman and Mrs. Farman's two daughters, Mrs. Marlow and Mrs. Baker, and refused, actually both girls were married at that time, and refused to co-operate, or listen to their husbands in any way, shape or form. It was quite alarming to the whole family.

Q. And the whole family wanted him out in 1946; is that correct, sir?

A. I don't believe that that came up in 1946, Mr. Gardner.

Q. You mean you wanted him to be supervisor in 1946, sir?

A. No. We wanted him to resign as supervisor, during 1946, but remain in the company.

Q. Now, when did you first discuss with him the possibility of resigning as supervisor, Mr. Farman?

A. I will make it broad; during the years of 1946 and 1947.

(Testimony of Gerald I. Farman.)

Q. During the early part of 1946? [246]

A. I wouldn't say the early part; during the year of 1946 and 1947.

Q. Excuse me, sir. When was the executive committee set up?

A. In September or October, 1945.

Q. I believe you testified that it was immediately a failure? A. Yes, sir.

Q. Did your desire to have Mr. Smith removed as supervisor stem from that?

A. That was only one part of the complete picture.

Q. But in any event, from that time on, you wanted him out of there?

A. Not from that time on.

Q. From what time?

A. The build-up of many things that have been testified to, the lack of research, market research. I have gone over this, the lack of any interest of new products, the lack of market research.

There was a combination of many things that caused concern in the family.

Q. In the family. And this concern was apparent as early as 1945, was it not, sir?

A. Yes, it was. It was, prior to that even.

Q. In fact, you might say the concern of the family [247] started back in 1931, wouldn't you, as to the management of this business?

A. I would not say that, no.

I said that when Mr. Colyear presented an employment contract, it caused a very unsatisfactory,

(Testimony of Gerald I. Farman.)

caused dissension. Let me put it that way, please.

Q. All right, sir. Now, let's get on up into 1947.

Well, wait a minute. Let's go back to '46 again. You have testified that the sales for that year were inflated? A. Yes, sir.

Q. Because you had back sales, or back orders that you were filling? Other than that, what about the financial picture of the corporation?

A. Well, I was made vice president and had an active part in many financial arrangements during 1946, but that I believe with, had at least a small part of it, served in a small way, the success, financial success during that year.

Q. I see. Was the company financially sound at the end of the year, sir?

A. The company was financially sound, if in your—on the basis of the financial statement only.

Q. What was wrong with it? [248]

A. We had outgrown—we had not—I retract the word outgrown—we did not have proper facilities in Chicago to develop products that were being marketed by competitors during that period, and we were not doing anything during that period to build a solid firm company for the future.

Q. Now then, let's get into the year 1947. Apparently the members of the family must have become very alarmed in the early part of '47. I say that, having in mind the action that was instituted on behalf of them.

Mr. Hall: Would you mind talking a little louder, please, Mr. Gardner?

(Testimony of Gerald I. Farman.)

Mr. Gardner: I am sorry.

Q. (By Mr. Gardner): The action that was instituted on behalf of the family to have Horace Smith, Jr., removed as supervisor. Now, could you tell me, sir, when did these discussions relating to the action, itself, begin?

A. I could not tell you the exact date, and be correct. I would say it was from—came up yesterday, and I was unable to answer it—it was after, during the spring months, or the summer months.

I couldn't answer that, because it is a hard thing for me to remember back. Specific dates, I have no records of any. [249]

Q. Well, the action was apparently filed in April of 1947, so that should help you pinpoint it, at least.

A. I recall that yesterday that was also mentioned. But this action was the outcome of at least one full year of 1946.

Q. It went clear back to the whole year of '46?

A. I imagine it did.

Q. I see, sir.

A. It would be my idea, because nothing could be done.

Q. Well now, was there anything startling in these monthly statements that you looked at for 1947? A. Nothing at all. It bore economy.

Q. 1947, sir?

A. Oh, 1947, I am sorry. Startling thing is the loss.

Q. Loss. Did the company have any cash on hand, sir; did the company have any cash on hand?

(Testimony of Gerald I. Farman.)

A. At the end of the year, their cash was depleted.

Q. At the end of the year '47?

A. Yes. I say it wasn't depleted; it was below the point of being sound.

Q. In fact, at the beginning of the year, it wasn't very good, either, was it? [250]

A. I would have to see the statement. I am sorry. I could tell you.

Q. Well, was that one of the reasons that you had some concern about this corporation, the fact that they didn't have any working capital and were borrowing money?

A. Not necessarily. I borrowed money when my capital was low.

Q. I seem to recall that you looked at one of these audit reports here, sir, and expressed some concern over a $15,000.

A. That was a $15,000 note.

Q. Would you explain what that concern was?

A. Well, I will have to explain it in my way, Mr. Gardner.

My prediction was, to begin with, that I—this is my opinion that I stated yesterday—that the company could not stand, could not weather two years loss in going, at the end of 1947 the working capital had been depleted, and in 19—the end of 1947, there was a note of $15,000 owing to the bank, which would naturally be a factor in borrowing more money.

(Testimony of Gerald I. Farman.)

Q. Now, this actually was a sort of thing you had been predicting all along, wasn't it?

A. I predicted without a, without a program that Schalk could not survive. [251]

Q. And you had been predicting that in 1946, hadn't you, sir; this is just kind of fulfillment of the prediction you had been making?

A. I imagine that you may say it that way. [252]

* * *

Afternoon Session—1:30 P.M.

GERALD I. FARMAN

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

Mr. Gardner: Can I have this marked for identification as Respondent's next in order, [253] please?

* * *

The Clerk: Respondent's Exhibit J for identification.

(The document above referred to was marked Respondent's Exhibit J for identification.)

(Testimony of Gerald I. Farman.)

Cross-Examination
(Continued)

By Mr. Gardner:

Q. Mr. Farman, I show you what has been marked Respondent's Exhibit J for identification, and ask you to examine that book, and state whether or not that contains the minutes of the board of directors for the Schalk Company?

A. It is the minute book of the Schalk Chemical Company.

Q. It is the minute book, sir; all right, sir.

At this time, I offer this document in evidence, your Honor. [254]

* * *

The Clerk: That is Exhibit J.

(The document heretofore marked for identification as Respondent's Exhibit J, was received in evidence.) [258]

* * *

Q. (By Mr. Gardner): Mr. Farman, referring to Exhibit J, page 283 thereof, at the top of the page, it stated the minutes of the adjourned meeting of board of directors of Schalk Chemical Company, and the date is 27th day of December, 1946.

I see on this document also that G. I. Farman was present as a director; is that correct, sir?

A. That is correct.

Q. You were there on that date?

A. I remember that date very well; yes, sir.

(Testimony of Gerald I. Farman.)

Q. You do, sir? Now, going down to the bottom of page 283, and I quote:

"After a considerable discussion with reference to the amount of dividend to be declared, Director G. I. Farman, presented the following resolution and moved its adoption:

"Resolved: That a dividend of $42,000 be, at the rate of 42 cents a share, out of the net profits of this corporation, earned during the calendar year 1956, be, and the same is hereby declared, and that the same be immediately paid out and distributed to the shareholders of [260] record of said corporation, on this the 27th day of December, 1946."

Do you recall making that resolution, sir?

A. I recall the instant. To begin with, Mr. Smith proposed a dividend in the amount of $42,000 accompanied with a letter from Mr. Rauch, which letter is a matter of record, that we had to pay out 70 per cent. I think it comes under provision 102, Internal Revenue Laws, 70 per cent of our—if I fumbled that part, I am sorry—70 per cent of our earnings.

I recall so well my statement. I said if we have to do it, I would make the resolution, but I would like to hold off for a few days to investigate the necessity of paying this dividend.

I objected seriously because I wanted to plow back; first purchase the property, next door, which was available at a very reasonable figure for expansion; number two, I wanted to buy automatic equipment.

(Testimony of Gerald I. Farman.)

I did not write these minutes, so I will not swear to their authenticity.

Q. Is it your statement, sir, that the minutes are not correct?

A. I didn't write the minutes. I will not swear to their authenticity. I do not recall making that motion. I gave a proviso in my recommendation. [261]

Q. Well, let's continue with this exhibit just a little but further, that is referring to Exhibit J, page 284, near the top of the page.

"Thereupon, G. I. Farman brought up the matter of an additional bonus to the executive officers in accordance with the discussion held at the meeting of December 16, 1946. After some discussion, Director G. I. Farman presented the following resolution, and moved its adoption:

"Resolved: That a bonus in the sum of $1,200 be paid to the president, Horace O. Smith, Jr., and a bonus in the sum of $1,200 be paid to each of the vice presidents, Hazel Farman, and G. I. Farman, as an additional salaries for their services performed during the year 1946."

Do you recall making that resolution, sir?

A. I do not directly recall it. I don't remember it at all.

Q. Is it your statement that you did not make the resolution, sir?

A. I did not state that, Mr. Gardner. I said I do not recall making the resolution.

Q. Thank you; thank you.

In any event, making such a resolution would be directly contrary to your policies as you have ex-

(Testimony of Gerald I. Farman.)

pressed them; that is, they should be plowed back into the [262] corporation, isn't that correct, sir?

A. That was a very small amount of the earnings for that year. I believe it amounted to $1,200 each, or total amount of $3,600, to be paid to the three executives or the three members of the executive committee.

Q. But the $42,000 dividend was rather sizeable, was it not, sir?

A. It was a very sizeable dividend.

Q. Yes.

A. I would like to go on record that I bitterly and Mrs. Farman bitterly opposed the paying of that dividend. We begged them not to, and they railroaded it through because they controlled the board.

Q. Might I inquire, sir, was the resolution to pay the $42,000 your resolution?

A. I said I did not write the minutes. I recall the instant very clearly, where Mr. Smith recommended, on Mr. Rauch's letter, that the dividend be paid. And I recall very definitely, if we had to pay the dividend, I would naturally have to go along with it.

But I asked for time to investigate whether we had to make, pay the dividend, and I did investigate, and incidentally, prior to anything, any of my investigation, the dividend was railroaded through by Mr. Smith and his two—I call them—yes-men. [263]

The Court: Did you vote for or against it?

The Witness: I voted against it. Mrs. Farman voted against it. We definitely know that.

(Testimony of Gerald I. Farman.)

Q. (By Mr. Gardner): Is it your testimony then, sir, that these minutes relating to the Exhibit J, page 283, 284, relating to the meeting of the board of directors of the Schalk Company, 27th day of December, 1946, are incorrect?

A. I will not make a direct statement there.

Q. Just yes or no.

A. I will not say they are incorrect. I may say they are not complete. They were not written by me and I had nothing to do with it.

Q. But you would not say they are incorrect?

A. I will not say they are incorrect. I would not make a misstatement of fact. I don't know.

I would say they are not complete, that they don't bring out the fact that Mrs. Farman and I bitterly opposed it.

Q. You can read the document, Mr. Farman.

A. I had time to read the whole thing, but it is neither here nor there, but I said if it does not bring out the fact that when Mrs. Farman and I opposed this, at that meeting, or a meeting following it, the minutes are not complete. I will say they are incorrect and not [264] complete.

Q. They are not complete. They are accurate as far as they go? A. I don't know.

Mr. Hall: Your Honor, I object to continued questioning on this. The witness has stated his position.

As the court knows, and Mr. Gardner knows, minutes are traditionally prepared by attorneys interested with the parties, and most often do not re-

(Testimony of Gerald I. Farman.)

flect every conversation in every matter that is discussed at a meeting. The minutes reflect the opinion of the author of the minutes, as to what should appear in the minutes. And it is the attorney who prepares them that often decides what should appear in the minutes.

Now, Mr. Farman has answered the question two or three times, to the best of his recollection, that he didn't make the motion.

The Court: Do the minutes reflect who voted for or against the resolution?

Mr. Gardner: Yes, your Honor. I read at page 284, Exhibit J.

"The motion to adopt said resolution—that is relating to the $42,000 made by Mr. Farman"—was seconded by Hazel Farman and upon being presented to the board, was adopted by the affirmative vote of all directors [265] present.

The Court: Mr. Farman, is it your testimony that that is an untruthful statement?

The Witness: It is my testimony that Mrs. Farman and I bitterly opposed it.

The Court: That is not being responsive.

The Witness: I am sorry.

The Court: It is not responsive to my question.

The Witness: Pardon?

The Court: I want to know whether you voted for or against the resolution?

The Witness: I voted against the resolution.

The Court: Then is it your testimony that that statement in the minutes is untruthful?

(Testimony of Gerald I. Farman.)

The Witness: It is.

Q. (By Mr. Gardner): Is it also your testimony, sir, that the statement in the minutes relating to the resolution, that is the presentation by G. I. Farman, that the $42,000 dividend be declared, is that also untruthful, sir?

A. I have answered it that I do not recall making the statement. I answered it exactly the way I recalled it, that if Mr. Rausch, in his letter is correct, we will have to pay them. I asked for time and I investigated and found that we did not. [266]

Q. May I interrupt, sir? I am only asking whether or not you did make the resolution, sir?

A. I have answered it.

Q. How did you answer? Did you make the resolution, sir?

A. To my best recollection I did not make a resolution.

Q. But you may have?

A. I stated, Mr. Gardner, that I recall the instant very well, and stated at the directors' meeting that if Mr. Rausch is correct, we will have to pay a dividend, period.

Q. Well now, you have testified just now to something that might be a little different. If you have to pay the dividend, why did you bitterly oppose it?

A. Because I didn't feel we had to pay the dividend, and asked for a time to investigate, and I took the time and came back to the board and stated we did not have to pay the dividend.

Q. You stated to the board you did not have to

(Testimony of Gerald I. Farman.)

pay the dividend? A. That is correct.

Q. When did you make that statement to the board, sir?

A. Why, in January, at the—at some meeting in January. [267]

Q. Some meeting in January of what year, sir?

A. 1947.

Q. All right, sir.

A. May I retract that statement? I made that statement to Horace O. Smith, Jr., the president, that I had investigated it and I would be glad to go on record who I talked to in regard to that matter.

Q. Well now, did you or didn't you—excuse me.

A. That we did not have to pay the dividend, and the proper thing would be to plow in, to increase our facilities in Chicago, by land with the——

Q. Now, did you so inform the board of directors?

A. I don't recall that, Mr. Gardner. I recall going to Mr. Smith about it.

Q. As a natural matter of fact, you didn't have a board of directors' meeting in January of '47, did you?

A. I don't know. You have got the minute book.

Mr. Hall: Well, Mr. Gardner, it shows there was one in February, '47, does it not?

Mr. Gardner: There was one in February, yes.

Q. (By Mr. Gardner): As I understand your testimony right now, is to the effect that you did not

(Testimony of Gerald I. Farman.)

inform the board of directors that they did not have to pay this dividend; is that correct, sir? [268]

A. That is correct. I will also state that I also informed my wife, and Mrs. Farman's two daughters, and their husbands, that we did not have to pay the dividend.

Q. But you never did inform the board of directors?

A. I don't believe I did. It would have been useless to do it. The board is controlled by Bob Smith, and would have had no effect on the board. They had already railroaded it through, any way.

Q. I see.

The Court: If you say you did not present the resolution, who did?

The Witness: The matter, your Honor, was presented by Mr. Smith originally, to pay a [269] dividend.

* * *

Q. (By Mr. Gardner): Mr. Farman, referring once again to Exhibit J, going to page 280 thereof, and specifically to the meeting of the board of directors of Schalk Chemical Company on the 16th day of December, 1946, do you recall being present at that meeting, sir, as a director?

A. Yes, I was there. I had to read far enough to identify it.

Q. You take your time, sir.

Now, going over to page 281, at the bottom of the page, would you read beginning with that second line from the bottom?

A. You want me to read this out loud, sir?

(Testimony of Gerald I. Farman.)

Q. Would you, sir?

A. Yes. "Director G. I. Farman called the attention of the board to the fact that he had contracted an indebtedness of $16,000 for automatic filling machine and automatic crack filler. He also suggested that it would be advisable to purchase the automatic filling machine for hand pound packages of Savabrush and that such a machine would cost approximately $8,000 installed."

Far enough?

Q. Very good, sir. Thank you.

Now, do you remember whether or not the $8,000——

A. Pardon me. May I see those minutes once more? [270]

Q. Surley. The witness is now examining Exhibit J.

A. I have had enough. Thank you.

Q. Do you recall whether or not the automatic filling machine which you suggested be purchased at a cost of $8,000 was ever purchased?

A. I do, yes. The minutes are incorrect, but it is an error in probably transposing or something.

Q. All right, sir.

A. It says a crack filling machine, does it not?

Q. It says an automatic filling machine for half pound packages of Savabrush.

A. For half pound Savabrush. That is incorrect. I am sorry. But it is incorrect.

I recall buying an automatic machine, or not buying an automatic machine. I didn't buy the ma-

(Testimony of Gerald I. Farman.)

chine, I recommended the purchase of the machine. I did not buy the machine.

Q. Do you know whether or not the machine was purchased?

A. The machine was purchased, yes.

Q. The machine was purchased. All right, sir.

Do you recall where that machine was installed, here or in Chicago?

A. The machine was not installed until I went in in 1948. It set for one full year at least, at least one full year, in the crate. It was never installed until I was, [271] went in as president after January 15, 1948.

Q. Was the machine in Chicago, or was it in Los Angeles?

A. It was in Chicago. I think, if I may ask, that when I had this machine—so we are not talking about two different machines—I am talking about an automatic pneumatic scales machine for filling three ounce Waxoff. You see, the minutes confuse me, sir.

Q. I see.

A. The purchase price is approximately correct, $8,000 on the machine I am talking about.

Q. $8,000. And that machine was not used, you say?

A. It was not installed until after January 15, 1948.

The Court: Were there other automatic machines that were installed and used prior to that time?

A. That was the first piece of automatic equip-

(Testimony of Gerald I. Farman.)

ment that the company ever purchased for the Chicago plant.

The Court: Was there any piece of automatic equipment purchased and used in either plant, prior to your becoming president?

The Witness: The Los Angeles plant had a pneumatic scales packaging machine for Hydro Pura for as long as I have known the company, which dates back to 1921. That machine was installed at that time, or before my time. [272]

The Court: And that was the only one?

The Witness: Yes, sir.

The Court: Prior to the new machine that was installed after you became president?

The Witness: May I qualify this, please, your Honor?

It is the first fully automatic I purchased, or caused to be purchased, two semi-automatic machines operated by people in 1946. I testified to that yesterday. This is fully automatic that we are talking about.

The Court: Were these semi-automatic machines in use prior to your becoming president?

The Witness: No, sir. Oh, pardon me. No, I misunderstood.

Yes, these two machines were put in service in 1946.

The Court: In Chicago, or——

The Witness: In Chicago; yes, sir.

The Court: Is that as a consequence of your visit to the Chicago plant?

(Testimony of Gerald I. Farman.)

The Witness: It was, sir.

The Court: Have you made any recommendations in respect to packaging for the Chicago plant that were not adopted in 1946?

The Witness: I recommended that we purchase all automatic equipment, inasmuch as we had made quite a bit [273] of money, and I wanted to plow it into automatic equipment, sir. And this one particular machine was purchased either by Mr. Smith or by Mr. Fulmer, the manager there. I recommended its purchase, investigated and recommended its purchase, but I also recommended that we buy all automatic equipment.

Q. (By Mr. Gardner): While we are on the subject of the Chicago plant, I believe you testified, Mr. Farman, that in some period you desired to obtain additional quarters for that plant so that you may enlarge? A. That is right.

Q. And when was that?

A. During 1946 a plant became, was—become available in one block from our present plant, the corner of 47th Street and Christiana, and it was known as the Philco Building.

It was built by the Philco Company that was available and presented to us for purchase. Mrs. Farman and I were both in Chicago, inspected the plant, and called Mr. Smith on the phone and recommended the purchase of this building. The purchase price was $118,000.

Q. $118,000. Now, from that time, sir, up to the

(Testimony of Gerald I. Farman.)

present time, have the facilities in the Chicago plant——

A. Will you pardon me, I cannot hear you. [274]

Q. Excuse me, sir.

A. You turn your back and I miss it.

Q. From the time that you made your recommendation that the additional building be purchased, that was in 1946 you said?

A. Yes, sir.

Q. To the present time, would you state just how the facilities in the Chicago plant have been enlarged?

A. The facilities in the Chicago plant have not been enlarged. In 1948, when we took—I was made president of the Schalk Chemical Company, the corporation owed money, and it was always, and in all of our proposals, the intent of the family that the corporation should pay off the $45,000 to Mr. Smith. It was always proposed, in many cases proposed, in every case proposed that the family would loan the money to the corporation, because the corporation was short of money, that they would loan the money to the corporation on the basis that the corporation would pay them back, to pay off Mr. Smith.

We did not have the money to expand our plant, and had been plowing in as much as we could, to acquire the land. Inflation has taken hold, as we are all familiar with it, and properties that we could have purchased back in 1946, land alone at 75 or even 60, was the price of the property next to us.

(Testimony of Gerald I. Farman.)

It is now worth dollar and a half. [275] It is not for sale, but that is the appraised value.

Q. In other words, in 1946, you thought it was advisable to incur an obligation of approximately $118,000? A. $118,000, I recommended it.

Q. You recommended it?

A. Yes, sir. [276]

* * *

The Clerk: Respondent's Exhibit K for identification.

(The document above referred to was marked Respondent's Exhibit K for identification.)

Q. (By Mr. Gardner): Mr. Farman, would you examine Respondent's Exhibit K for [277] identification—— A. Minute books.

Q. ——and see if you can identify that exhibit, sir? Just the document in general, please, sir.

A. Well, I had to read the document to know.

Q. I see, sir.

A. To know what it contained. You want me to identify this document?

Q. Yes.

A. The entire book here, the book is a minute book.

Q. The book is the minute book? A. Yes.

Q. That is Exhibit K?

A. Exhibit K is the minute book of the Schalk Chemical Company.

Mr. Hall: Volume V.

The Witness: Volume V.

Mr. Gardner: Volume V, yes.

(Testimony of Gerald I. Farman.)

The Court: Covering what period?

Mr. Gardner: Covering the period April 17, 1947 to January 16, 1952.

Q. (By Mr. Gardner): Is that correct, sir?

A. Is that the latest? Let me look. Yes, sir, that is correct.

Q. Going to page 60 of Exhibit K, the date December [278] 15, 1950, do you recall being at a special meeting of the board of directors of Schalk Chemical Company, sir?

Mr. Hall: Your Honor, the witness is reading from Exhibit 5 attached to the stipulation.

Mr. Gardner: Yes, Exhibit 5, your Honor, of the stipulation.

The Witness: Yes, I recall this meeting.

Q. (By Mr. Gardner): You were present, sir?

A. Yes, sir.

Q. Now, this is after you had been in control of the corporation from what is it, January of 1948, to this time, sir?

A. Yes, sir.

Q. In 1946, at the time you recommended the acquisition of additional property in Chicago, could you tell us what time of the year that was; was that the latter part of the year?

A. I am sorry, I didn't get your question, Mr. Gardner.

Q. All right, sir. I believe you stated that in 1946 you made a recommendation that Schalk Chemical Company purchase additional property in Chicago?

A. Right.

(Testimony of Gerald I. Farman.)

Q. Now, could you state what time of the year that [279] was in 1946?

A. I could not. I made two recommendations in 1946 to purchase property, and I couldn't tell you the time of the year of either one. One was a recommendation that we buy the adjoining property at 60 cents a square foot; the other one was the Philco Building, known as the Philco Building at the corner of 47th and Christiana.

Q. Now, what was the cost, approximate cost of the Philco Building?

A. $118,000.

Q. And what was the approximate cost of the other building, sir?

A. The other building was not a building. It was vacant land at 60 cents a square foot adjoining our plant.

Q. I see. And how much would that have cost?

A. I recall the overall amount was $32,000. It is close, that is the round figure, the amount.

Q. So, you would have recommended in 1946 spending, or incurring obligations up to $150,000?

A. Definitely not. One was an alternate. First I recommended the additional property adjoining the factory be purchased for future expansion in the amount of 60 cents a square foot, vacant property.

Later on I recommended, that was turned down definitely. [280]

Q. When was this recommendation made, sir?

A. This was in 1946.

Q. In early '46, sir?

(Testimony of Gerald I. Farman.)

A. I can't say, sir. Sorry, I don't recall it. Later on, the same year, I recommended the purchase of the Philco Building in the amount of $118,000. At that time we had a substantial equity in the building that we were in, and the building is a very saleable building.

As a matter of fact, the equity at that time was far, was quite a bit more than we paid for the building. My proposal was that we would sell that building and apply the amount of money we received from the building on the Philco Building.

Q. And what was the——

A. The Philco Building, I had talked to the Central Manufacturing District, and they agreed to finance the Philco Building for us on a 10 or 15 year plan, either one we choose.

Q. And what was the extent of the liability that would be incurred?

A. About $75,000, in round figures.

Q. About $75,000? A. About $75,000.

Q. In 1946?

A. In 1946. Had we had our dividends, instead of [281] paying dividends, taken the $42,000 that would have brought that from $75,000 down $42,000.

Q. Now, referring to page 63 of Exhibit K, at the bottom of the page, this relates to the minutes of the meeting of December 15, 1950, we see that there is a report or consideration at least, being given to the purchase of a building in Chicago whereby the net result of the transaction would result in a liability of $155,000.

(Testimony of Gerald I. Farman.)

Do you see that there, Mr. Farman?

A. I have read part of it. I don't want to take too much time.

Q. Is that correct, sir? A. Yes.

Mr. Hall: Mr. Farman, you may read all of it. We have the time.

The Witness: I just read the first part of it, and I don't even——

Mr. Hall: Might as well read it all.

The Court: You may take all the time you need, Mr. Farman.

The Witness: Thank you.

Mr. Hall: You may read whatever you want, and take as much time as you want, Mr. Farman.

The Court: It is the material which has been pointed out to the witness, the same as what appears beginning at [282] page 6 of Exhibit 5.

Mr. Hall: That is right, your Honor.

Mr. Gardner: Yes, your Honor.

Mr. Hall: I apologize, your Honor, in making the exhibit we didn't number the same as the pages in the book.

The Witness: All right, I have read enough of it, I believe.

Q. (By Mr. Gardner): All right, sir. Referring specifically to the wording in the minutes relating to the liability of $155,000 shown at the top of page 64, Exhibit K, it states:

"It was the opinion of the chairman that the company would be unwise to incur a debt in such proportions."

(Testimony of Gerald I. Farman.)

Were you the chairman then, sir?

A. I was.

Q. And it was your opinion at that time it would be unwise to incur a debt?

A. That is right.

Q. Like that? A. That is right.

Q. Now, in 1946, you didn't think it was unwise to incur such a debt, did you, sir?

A. No. We had the money in 1946.

Q. Yet, I believe you testified that it was your [283] opinion that the company would go in the red in 1947, and that you knew this in 1946?

A. I didn't say I knew it. I said that I predicted it.

Q. You predicted it, and in spite of this prediction, you were still willing to incur a liability of $118,000 at that time?

A. Had all things been equal, and Mr. Smith cooperated with the executive committee, none of this would have occurred. Mr. Smith could well have been part of the company today, and could well have been the president of the company. We wouldn't had had losses and wouldn't have had this tax matter, or anything else.

Q. Would you state, sir, how that affects your change in judgment?

A. Well, when I call it simple arithmetic, Mr. Gardner, in business, we paid out to the U. S. National Bank, or Union Bank and Trust—pardon me—the sum of $15,000. We had a large advertising

(Testimony of Gerald I. Farman.)

debt. This was in 1948. I am starting now in January 15, 1948.

We had a large advertising debt. We have very little working capital, a very low working capital. We were faced with a $5,000 debt to pay to Mr. Smith. That amount of money had to come from earnings, and it had to come prior to, or be available in the first part of January [284] or the first part of 1951. I do scratch that January 1 part of 1951.

It was my duty and my business to accumulate $45,000 to pay off this large indebtedness, and certainly, it would have been, I could be very well criticized for misjudgment and mismanagement had I recommended an expenditure of any large amount during that period, or at this time of this meeting.

Q. I see, sir. Now, I believe you have testified that in 1945, when you first came to the company, that you had been alarmed by some of the activities of the prior supervisor, Mr. Colyear, and in part at least, some of your alarm as to the future was a result of certain studies you had made or were making.

Did you make those studies in '45, about, sir?

A. I am afraid I couldn't follow the question, Mr. Gardner. Would you restate it, please. I am sorry, I didn't follow it.

Q. I understood you made certain studies of the corporate business.

A. In 1945 now you are talking about?

Q. Well, I may be in error, but that is what I

(Testimony of Gerald I. Farman.)

understood your testimony to be, that sometime in there you did make a study.

A. That is correct. [285]

Q. Of the business, was that in 1945, sir?

A. I made several studies. I made a study of the business in 1945, in the latter part of 1945.

Q. I see.

A. During 1946, during 1947.

Q. Now, going back to 1939, that was the year just preceding the loss year, wasn't it, sir?

A. Yes.

Q. And at that time, you were rather concerned because emphasis was being placed on—what was that, Double X?

A. Yes.

Q. Now, what is Double X, sir?

A. Double X is a varnish remover.

Q. A varnish remover. Now, what was the reason that you were alarmed about that?

A. Double X is a very high profit item, and was carrying a large percentage of the load, meaning the cost of operations, and selling for the company. It was a high volume item.

Q. But as I understood your testimony, you were afraid that that item would be outmoded because of sanders; is that correct?

A. I said that the sale had decreased materially, and one of the reasons that it had decreased, that the use [286] of electric sanding machines was getting more popular every day.

I also testified that other products were being

(Testimony of Gerald I. Farman.)

introduced to the market, that were easier and more efficient that Double X.

Q. Well now, is a sander easier than any varnish remover, sir?

A. I am afraid that it is a matter of conjecture. I personally wouldn't want to use a sander. It is a very hard thing to do.

Q. I see. Well now, sir, I see in some of these minutes, referring to Exhibit K, which at this time I would like to offer, Exhibit K, in evidence. [287]

* * *

(The document heretofore marked for identification as Respondent's Exhibit K was received in evidence.)

* * *

Q. (By Mr. Gardner): Mr. Farman, referring to Exhibit J, again, page 298, under date of February 26, 1947, would you examine that page and state whether or not you were present at a board of directors' meeting on that date, sir?

A. I remember the meeting and I was present.

Q. Do you remember the discussion regarding Celloglaze?

A. I remember investigating the product. In fact, [289] I went to Minneapolis where Celloglaze was made, and talked to the owners of it, that were manufacturing the product there, in Minneapolis.

Q. Do you know whether or not Celloglaze is presently on the market, sir?

(Testimony of Gerald I. Farman.)

A. I do not know. It was, for many years after that date, but I can't tell you as to date.

Q. Well, after you took over in 1948, did you make any effort to get Celloglaze?

A. I didn't have any money to do anything for two or three years.

Q. In other words, you did not make any effort to get Celloglaze?

A. No, sir.

Q. Did you at any time subsequent make any effort to get Celloglaze?

A. I often thought of it, but I didn't have any money to do anything, and the most necessary thing, is the thing I repeat, that we get enough money to expand our facility so that we can manufacture more products.

The Court: Do all of your operations consist of manufacturing, or do some of them consist merely of packaging raw materials that you buy?

The Witness: Your Honor, I think manufacturing is a misnomer. I think it should be formulation. We don't [290] manufacture raw products. We buy raw products from suppliers who formulate them, and formulation in the form of mixing; then we package them and sell them.

I personally do not believe the word manufacture is correct. I think it should be formulation of products; packaging is the important function.

Q. (By Mr. Gardner): Referring to Exhibit K, page 5 thereof, the meeting of May 30, 1947, would you review that and refresh your recollection as to

(Testimony of Gerald I. Farman.)

whether or not you were present at that meeting, sir?

A. Are you going to refer to all of the minutes? Do you want me to read them?

Q. No. I just asked you if you were present?

A. I was present.

Q. Now, referring to page 7 of Exhibit K, the continuation of the minutes of the meeting of the board of directors of Schalk Chemical Company for May 30, 1948, at about the middle of the page there is a statement which reads as follows:

"Director G. I. Farman thereupon stated that he would like to have a statement of the costs on each of the individual products manufactured by the Schalk Chemical Company, showing the profit on each.

"Thereupon, a discussion took place as to the [291] feasibility of determining cost accounting in connection with the request for a statement of costs. Mr. Farman stated that the records which he had made up for the year 1945 showed an operating overhead of 14.2 percent, sales expense of 13.88 per cent, and administrative expense of 12.07 per cent, and advertising expense of 22 percent; making a total of 62.15 percent as the cost of operating during the year 1945."

Do you recall making that statement, Mr. Farman?

A. I don't recall it, no.

Q. Do you recall making that analysis?

(Testimony of Gerald I. Farman.)

A. I don't recall it. I made many analyses and this specific one I could not say I recall it definitely.

Q. Do you recall whether or not at a subsequent date the figure of 62.15 percent as shown on page 7 of Exhibit K was corrected to read 55 percent?

A. This——

Mr. Hall: By Mr.——

The Witness: This is a statement by Mr. Rausch. I don't recall the statement, no more than I recall——

The Court: What are you pointing at?

The Witness: Mr. Rausch is the——

Mr. Gardner: We are pointing at page 12 of Exhibit K, sir. [292]

Q. (By Mr. Gardner): I would like to refer you to page 10 of Exhibit K, sir, relating to a meeting of the board of directors for June 19, 1948; would you look at that and state whether you were present at that time, sir?

A. Yes, I remember.

Q. Do you remember whether or not this was what took place as shown by page 10 of Exhibit K:

"Thereupon, a discussion ensued with reference to the figures which Director G. I. Farman had given at the last meeting with reference to the overhead and cost of production during the year '45. The figures which Director Farman contended represented the overhead for that year was 67.78 percent. Director Rausch stated that there was an error in these figures, and that the overhead was approximately 52 percent, and that in his opinion the figure

(Testimony of Gerald I. Farman.)

used by Mr. Farman included a double charge for factory labor."

Do you recall that, sir?

A. I don't recall it. It is a simple matter of checking.

Q. That was one of the things you were complaining though, was the increase?

A. The big thing that I was complaining about, that you haven't brought out, is my complaint of spending the large amount of moneys in 1945, 1946, and 1947 on [293] advertising. Those were major factors. And if they are not in the minutes, the minutes are not complete. I again say that I am not saying they are incorrect. I say they are incomplete.

Q. I would like to have you examine page 12 of Exhibit K, minutes of the meeting of July 9, 1947, and ask whether or not you were present at that meeting, sir?

A. I was present.

Mr. Hall: Mr. Gardner, I request that the witness be allowed to read that whole set of minutes, and the next succeeding minutes. That is, that he be allowed to read from page 12 through 17.

Mr. Gardner: You mean aloud?

Mr. Hall: No, no, to himself.

The Witness: How far did you want me to read?

I believe I have gone as far as necessary.

Q. (By Mr. Gardner): You have been examining the——

A. I have been examining——

(Testimony of Gerald I. Farman.)

Q. ——the pages in Exhibit K, sir?

A. The—well, the pages that were suggested from here to here.

Q. 12, 13 and 14 of Exhibit K?

A. I believe that is right.

Q. All right, sir. Do you recall making a recommendation [294] that a Milldew proover be sold by the company?

A. I recall making a very definite recommendation that a cleaner with a germacide added be introduced, be produced and introduced to the market by the company. The word "Milldew Proover" were words that were being batted around during the conversation. I recall very well stating that the only place that a milldew proover is of any—has any volume of sale is in the south and down in Florida.

Therefore, the important thing was to get a germacide in the product to kill fungus, germs, etc.

Q. Do you now have such a product, sir?

A. We do not, no, not as such.

Q. Do you recall the president—that is Mr. Smith—stating to you that one of the brokers for the Schalk Chemical Company had reported that the grocery trade would probably not be interested in such a product?

A. Well, Mr. Gardner, since this recommendation there must be at least ten very excellent products on the market that have a volume considerably over $100,000, each item over $100,000 a year.

Q. I am sorry, Mr. Farman, apparently I didn't make my question clear.

(Testimony of Gerald I. Farman.)

What I asked was whether or not the president, Mr. Bob Smith, Horace O. Smith, Jr., didn't state to you that he had a report from one of the brokers of Schalk [295] Chemical Company regarding the advisability of preparing and manufacturing that product; did he tell you that, do you remember?

A. I don't recall it. I read it in the minutes, and I assume it is correct.

Q. In other words, when he received an idea from you, he took steps to determine whether or not that idea might work, didn't he?

A. In this instance he did, yes, this one instance.

Q. This is the only instance?

A. That is the only instance so far that you have brought up.

Q. But in order to save time, Mr. Farman, it is reflected in the minutes that the president did investigate the possibilities of a market for a product suggested by yourself, or one of the other members?

A. This one product you are talking about?

Q. No. Any product as reflected by the minutes of the company.

A. I didn't write them.

Q. Would you say that would be correct?

A. I didn't write the minutes.

Q. All right, sir. Referring to page 10, sir, of Exhibit K, minutes for January 19, 1947, again——

A. Are these some that I have identified before? [296]

Q. I am not sure, sir; would you look it over

(Testimony of Gerald I. Farman.)

and see whether or not you were present at that time?

A. Oh, yes, I read that.

Q. You have read that?

A. Right. I was present.

Q. Going to page 10 thereof, second paragraph from the bottom:

"The president read several reports on the subject of fungicide, and stated that he would prefer to have reports from an agency recording sales in the southern territory as in his opinion this was a region product, and it seemed that the southern states were the place where it would most likely be sold. No action was taken by the board with reference to the fungicide.

"Thereupon, discussion ensued with reference to the waterproofing for concrete and cement. The president stated that so far he had not had time to receive reports from the various individuals that he had contacted, and requested this matter go over for two weeks.

"Director Farman conceded to the delay."

Do you recall that, Mr. Farman?

A. Yes, sir.

Q. In other words, your president was taking steps to determine whether or not these products were marketable wasn't he? [297]

A. Yes. I imagine he was in this particular case, that one instant.

Q. Now, that is two instances.

A. All right; that is two instances.

(Testimony of Gerald I. Farman.)

Q. All right, sir.

Referring to page 297 of Exhibit J, the minutes for the meeting held the 19th day of February 1947; do you want to examine that, sir, to see whether or not you were there?

A. Sure do. Yes, I was there.

Q. Now, referring to page 297 of Exhibit J, regarding Celloglaze:

"Thereupon, Director G. I. Farman stated that on his recent trip to Chicago, he went to Minneapolis and investigated a product known as Celloglaze, which is a liquid solution used as a furniture polish and as a polish for automobiles. Mr. Farman discussed the product in detail, and stated that he had procured a tentative contract with the owner of said product and the contract was presented to the board for its consideration.

"The president stated that he had made some investigation of this product, and most of the advice he had gotten was against the Schalk Chemical Company taking over Celloglaze.

"The president further stated that he desired to [298] make a further investigation of this matter, and it was thereupon suggested that the president communicate immediately with the Chicago office and have an investigation made by the office at Chicago, and send an immediate report back to the president as to the result of the investigation.

"Thereupon, the directors requested G. I. Farman to contact the owner of Celloglaze and request the

(Testimony of Gerald I. Farman.)

owner to extend for one week the option which he had heretofore taken concerning Celloglaze."

Now, do you recall that, Mr. Farman?

A. I do.

Q. This is another instance in which the president is taking steps to investigate the advisability of marketing this product, isn't it?

A. It is not.

Q. All right, sir.

A. This is another case of prejudice in any product that we offered. Mrs. Farman or any members of the family offered, there was prejudice entered into and it is evidenced by the fact that he did not accept these products. Had he accepted Celloglaze, he had accepted a mighty good product.

Q. Do you have it today, sir?

A. No, I don't have it. I manage to solve the market. [299]

Q. Did you ever accept it?

A. I would have accepted it. I didn't have any money, I told you, prior to the last couple of years, and I haven't had any money to do very much with there, but we have introduced nine new products since that time.

Q. None of which is not Celloglaze?

A. None of which is not Celloglaze. I know Celloglaze was an excellent product.

The Court: You mean none of which is Celloglaze?

The Witness: None of which is Celloglaze.

Q. (By Mr. Gardner): Just a couple of more questions.

(Testimony of Gerald I. Farman.)

I believe you testified that in 1946 you made a suggestion to the board of directors that they develop a paint varnish, or varnish remover of some sort; is that correct?

A. Paint and varnish remover is the word.

Q. What is it?

A. Paint and varnish remover.

Q. Paint and varnish remover; is that correct?

A. That is correct.

Q. Now, I believe you testified also that you did develop a paint and varnish remover in 1956; do you recall that, sir?

A. Yes. Did I say 1955 or '56? [300]

Q. Well, I have in my notes '56.

A. Well, it could be either one, sir.

Q. '55 or '56. Now, Mr. Althouse, I guess he is manager now, isn't he, for Schalk?

A. He is my assistant.

Q. He is your assistant?

A. Yes.

Q. Testified that it took approximately one year to get a product on to the market. Do you recall that, sir?

A. From the time of its—we start with the idea until it is on the market, yes, sir, I would call it, it is a fact.

Q. Could you tell me, sir, why it took from January of 1948 to sometime in 1955 or 1956 to get this valuable paint and varnish remover on the market?

A. I can very well, sir.

(Testimony of Gerald I. Farman.)

Q. Fine.

A. We didn't have any money as stated before. We had to save enough money to pay the $45,000 to Mr. Smith. We had to pay off a $15,000 indebtedness to the bank, and had to pay off an indebtedness, an X number of dollars that I don't recall, to the Central Manufacturing District on our contract for the property or land, or building in Chicago.

Therefore, we would not spend any money, only, [301] any unnecessary money for new products during the period of 1948, 1949, and 1950. We may have produced a product during that time but we were not spending money. We didn't have the money to spend in the meantime.

I believe Mr. Althouse testified, and I wish to testify, that there are at least 50 paint and varnish removers on the market, and it was only a "me too" products because our customers demanded that we put it in. We did that late in the game with all the competition that we had to face with it.

Q. There is just one other point, and then we are finished, Mr. Farman.

I believe you testified to the effect, or your assistant, Mr. Althouse, I don't recall which, testified to the effect that as of today you have 17 products; is that correct, sir?

A. There are 16 shown in our catalogue. We have 17 products.

Q. You have 17?

A. I believe that is correct.

Q. And your latest figures as to the profit de-

(Testimony of Gerald I. Farman.)

rived from your individual products indicate that 53 percent of your profit now comes from the new products; is that correct, sir?

A. This is Mr. Althouse's testimony, if I may correct [302] you and if that is his testimony, it is correct.

Q. And 47 percent then of your profit now comes from the same old tried and true products that you have always had?

A. I imagine that is correct. I would have to do some checking, but if that is Mr. Althouse's testimony, it is correct.

Mr. Gardner: No further questions.

Redirect Examination

By Mr. Hall:

Q. Mr. Farman, with regard to the question you last answered, which concerned Mr. Althouse's testimony, that the 53 percent of the gross sales in 1957 were the result or were attributable to the nine new products, and Mr. Gardner asked you if the 47 percent, the corresponding percentage was attributable to the eight old products, if I may say it that way, referring to your answer, do you put out any new products under what is called a private label?

A. We private label some bulk products, Mr. Hall. One of them is called Citrox, very high profit product, of secret formula that we put out only in bulk form. We put out several bulk products.

Q. And the total gross sales include those bulk products?

(Testimony of Gerald I. Farman.)

A. Yes, they do. [303]

Q. That would diminish the 47 percent that Mr. Gardner was referring to?

A. It would diminish it considerably.

Q. Now, at the beginning of Mr. Gardner's cross-examination, he asked you concerning your appointment, or the request made by Mrs. Farman and Mrs. Baker and Mrs. Marlow, that you assist them in regard to management of Schalk Chemical Company. Do you recall that line of questioning?

A. I recall the question, but I don't know as I——

Q. In what year did they request that you leave whatever job you had, and come to work for Schalk?

A. 1945.

Q. Did they request that at any time prior to that?

A. Well, there were many requests, not many, several requests made prior to 1940 by Mrs. Farman and the two girls that they would like to have me in Schalk, but in 1945 it was, it had reached a point where they requested very definite assistance.

Q. Now, Mr. Gardner questioned you at length on your prior occupations.

The Clerk: Exhibit 28 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 28 for identification.)

Q. (By Mr. Hall): Mr. Farman, do you know, or did you ever know a Captain C. L. Hahn? Captain, Corps of Engineers.

(Testimony of Gerald I. Farman.)

A. I did.

Q. Did you work for Captain Hahn?

A. I did.

Q. When was that?

A. During period of 19—I can't point it right down. It was probably during a part of '35 and '36, maybe part of '37. It is very hard to remember the exact dates.

Q. And was he your supervisor at that time?

A. He was at the time that I worked for him. He was my immediate superior, yes.

Q. Do you know a Captain Hahn or did you know Captain Hahn's signature at that time?

A. I did; yes, sir.

Q. Would you be able to recognize it today?

A. I would.

Q. I show you Plaintiff's Exhibit 28 for identification, and ask you if that document bears Captain Hahn's signature? A. It does.

Q. Mr. Farman, do you know what this document is, what is it called?

A. This is called an efficiency record, developed I believe originally by the Navy and used by the Corps of [305] Engineers in the War Department as to the efficiency of soldiers and officers and employees.

Mr. Gardner: No objection.

Mr. Hall: I offer this in evidence, your Honor, Petitioner's Exhibit 28.

The Court: Admitted.

(Testimony of Gerald I. Farman.)

(The document heretofore marked for identification as Petitioner's Exhibit No. 28 was received in evidence.)

Q. (By Mr. Hall): Now, Mr. Farman, Petitioner's Exhibit 28 is dated November 15, 1937, and it shows a classification for G. I. Farman at that time of assistant supervisor, operations, and a base rate of pay of $450 per month. Does that, does the exhibit reflect the true state of facts to the best of your recollection?

A. To the best of my recollection it is correct. It is signed by Captain Hahn and is an efficiency record.

Q. Now, the classification there is assistant supervisor, operations. Was your position with the WPA changed after that date, November 15, 1937?

A. I was advanced from assistant supervisor, operations, to deputy director of operations and later to director of operations.

Q. Now, in testifying concerning a $550 salary from [306] WPA, which position were you referring to?

A. Well, I was referring, and I believe that if I understood it correctly, all of our conversation was a director of operations, and that was the $550 salary I was referring to, as director of operations at WPA.

Q. And I believe you mentioned the figure $750.

A. I said——

Q. At one time——

(Testimony of Gerald I. Farman.)

A. I said that it was possible, and very possible, that it was that, I received a salary higher than $550. I don't believe I stated what I based it on, but if I may state that, I would like to have it in the record, if it is of any consequence.

Q. You base the $750 on? A. Yes.

Q. Go ahead.

A. I recall a meeting between the director of the Works, of the—western director of the Works Progress Administration, Mr. Langley and Col. Harrington, the chief engineer of the Works Progress Administration, in Mr. Conley's office, and they were requesting that I take over the position of—may I have that card just a minute. I don't know what they called it.

They had asked me to take over the duties and position and duties of district director of Southern [307] California, and at that time Col. Langley or Mr. Langley, stated, "Well, Farman, you are the highest paid civilian on the West Coast in the Works Progress Administration," and that my salary would be about what I was receiving at that time, and he said—I said, "Well, what is that," not thinking, and he said, "$750."

Now, I don't, I can't tell you that I received $750. I tried to make that clear the other day.

Q. Thank you, Mr. Farman.

Did you, at any time with the WPA, work for a Col. Dillon? A. Yes, I did.

Q. In what position were you when you worked with, or for Col. Dillon?

(Testimony of Gerald I. Farman.)

A. Col. Dillon was director of employment when I first went in in 1935; when I was first transferred from Washington I was assigned to him the first thing.

Q. How long did you work with Col. Dillon??

A. Well, actually, I can't recall in the personnel department how long I worked. It was rather a short period of time, and I was then transferred because of an opening in operations that they needed help, and—however, Col. Dillon was assistant or deputy director, so I was definitely under him for about three years, maybe a little more than three years. [308]

Mr. Hall: Your Honor, I would like to put a witness on out of turn for the convenience of the witness, and defer Mr. Farman's redirect examination until after this witness.

Mr. Gardner: No objection, your Honor.

The Court: You may do so.

Mr. Hall: Call Colonel Dillon.

COLONEL LEE S. DILLON

a witness called by and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Hall:

Q. Sir, are you Colonel Lee S. Dillon, Corps of Engineers, U. S. Army, retired? A. I am.

(Testimony of Colonel Lee S. Dillon.)

The Clerk: Would you state your address, please, Colonel Dillon?

The Witness: 3055 D Street, San Bernardino.

The Clerk: Mark Exhibit 30 for identification.

(The document above referred to was marked Petitioners' Exhibit No. 30 for identification.)

Q. (By Mr. Hall): Colonel Dillon, I hand you a document that has been marked Petitioners' Exhibit No. 30 for identification. Do you recognize that document? [316] A. I do.

Q. Will you briefly describe what it is?

A. It is a letter giving my opinion of the character and ability of Jim Farman.

Q. That letter is dated August 4, 1957?

A. That is right.

Q. And it is signed by you, sir, is that correct?

A. That is right.

Mr. Hall: I offer this as Plaintiff's Exhibit No. 30.

Mr. Gardner: No objection.

The Court: Admitted.

The Clerk: Exhibit No. 30.

(The document heretofore marked Petitioners' Exhibit No. 30 for identification was received in evidence.)

Q. (By Mr. Hall): Colonel Dillon, Petitioners' Exhibit No. 30 states that in 1940 you offered Mr. Farman a position, and according to the letter you got special authority from Washington to offer him

(Testimony of Colonel Lee S. Dillon.)

the position at what was then an "unusually large salary for a government engineer," and that ends the quote. What was the salary which you offered to Mr. Farman in 1940?

A. I had the authority to pay from $12,000.00 to $15,000.00. [317]

Cross-Examination

By Mr. Gardner:

Q. Colonel Dillon, what was the occasion for writing this letter, Petitioners' Exhibit No. 30?

A. As I remember it, I got a request from Mr. Guthrie for a letter as to my opinion of Mr. Farman.

Q. Did he state why he wanted your opinion, sir?

A. I don't remember whether he did or not.

Q. Do you remember what salary you employed Mr. Farman at in 1940?

A. I never employed him in 1940; he didn't accept the job. I had the authority to pay him from $12,000.00 to $15,000.00.

Q. He didn't accept the job?

A. He did not.

Mr. Gardner: No further questions.

Redirect Examination

By Mr. Hall:

Q. Colonel Dillon, did you know Mr. Guthrie prior to his contacting you?

A. I had met him, yes.

(Testimony of Colonel Lee S. Dillon.)

Q. Who was Mr. Guthrie?

A. He was a lawyer, I believe, who handled a lot of Mr. Farman's business. [318]

* * *

Mr. Hall: Call Mr. Farman.

GERALD I. FARMAN

called as a witness for and on behalf of the Petitioners, having been previously duly sworn, resumed the stand and testified further as follows:

Redirect Examination

By Mr. Hall:

Q. Mr. Farman, what is your age?

A. I will be 65 next month.

Q. Now, during the years 1935 to 1939 what was the highest position you held with the WPA when it was under the Corps of Engineers?

A. Director of Operations.

Q. And while you were in that position, did the office which you controlled make an accomplishment report of the work of that division?

A. It did.

Q. That was the Operations Division, is that correct? A. Correct.

The Clerk: Exhibit No. 31 for identification.

(The document above referred to was marked Petitioners' Exhibit No. 31 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you a book that has been marked Petitioners' Exhibit

(Testimony of Gerald I. Farman.)

No. 31 for identification, and ask you if that is the Accomplishment Report, or Report of Accomplishments of the Operations Division, Work Progress Administration, Southern California, which you referred to? A. It is.

Q. Was that prepared under your supervision?

A. It was.

Q. And at the time of this report, as Director of Operations, who was your immediate supervisor?

A. Colonel Donald H. Connelly.

Mr. Hall: I offer this as Petitioners' Exhibit No. 31.

Mr. Gardner: No objection.

The Court: Admitted.

The Clerk: Petitioners' Exhibit No. 31.

(The document heretofore marked Petitioners' Exhibit No. 31 for identification was received in evidence.)

Q. (By Mr. Hall): Mr. Farman, on cross examination it was suggested, on Mr. Gardner's examination, that at some time in your background you went broke. Was there ever any occasion on which on any business enterprise that you had that you went broke?

A. I never went broke.

Q. On cross examination you testified as to an [320] employment contract which Mr. Colyear demanded from Schalk Chemical Company in 1931 or 1932, I don't recall which year; when that contract was objected to, what did Mr. Colyear do?

(Testimony of Gerald I. Farman.)

A. Well, he got extremely mad, and then from that date on he refused to cooperate with any of the family.

Q. Did he take any other action at that time?

A. He sued the company for salary.

Q. Mr. Farman, Respondent's Exhibit J, which is Volume 4 of the Minute Books of Schalk, at Page 147, contains this following statement made by Henry O. Wackerbarth, the Secretary of the corporation, "On the 13th day of May, 1932, as Secretary of the Schalk Chemical Company, I was served with a copy of the summons and complaint in an action now pending in the Superior Court of the State of California in and for the County of Los Angeles, and entitled Curtis C. Colyear, Plaintiff, versus Schalk Chemical Company, a corporation, Defendant, No. 340461; that said action was brought by the plaintiff for the purpose of recovering the reasonable value of his services rendered to the corporation as general manager."

Is that the suit that you had reference to?

A. That is the suit I had reference to.

Q. And was that suit later dismissed?

A. It was later dismissed.

Mr. Hall: For the record I state that the resolution [321] and agreement of Mr. Colyear is set forth at Pages 157 to 158 of Respondent's Exhibit J, which is Volume 4 of the Minute Books of Schalk Chemical Company.

Your Honor, I think I made a misstatement before in reference to this exhibit. It is Respondent's

(Testimony of Gerald I. Farman.)

Exhibit J; it is on the wrong line here and I will ask the Clerk to correct it.

Q. (By Mr. Hall): Now, Mr. Farman, on cross-examination you testified I believe that you have followed the practice of endorsing to Mrs. Farman your salary checks from Schalk Chemical Company. Now, Mr. Farman, did you mean that you received no personal benefit from such funds?

A. Oh, no, I didn't mean it that way.

Q. What does Mrs. Farman use those funds for?

A. For the maintenance of her home and living expenses, from which I derive a benefit; I live there and I derive a benefit.

Q. Well, did you actually endorse the checks that you received?

A. I doubt if I endorsed very many of them; I hand the check to her and she deposits it in her account.

Q. Now, did you and Mrs. Farman enter into a property settlement agreement prior to your marriage? A. We did. [322]

Q. What was the general nature of that agreement?

A. Briefly, what was hers was her own, and what I had was my own, prior to our marriage.

Q. Now, regarding Mr. Fulmer, the former manager of the Chicago plant, or the Eastern Division of Schalk Chemical Company, how old was Mr. Fulmer in 1948?

A. Well, he told me he was past 65.

(Testimony of Gerald I. Farman.)

Q. Did he object to coming to California?

A. No, he welcomed it, to my best knowledge and belief.

Q. Now, on cross-examination, Mr. Farman, you testified that you thought Mr. Lieben was appointed manager of Schalk Chemical Company in place of Mr. Williams in 1931 or 1932. Mr. Farman, I refer you to Respondent's Exhibit J, which is Volume 4 of the Minute Books of Schalk, Page 255, in which there is a resolution as follows: "Resolved that H. C. Lieben be appointed the general manager of Schalk Chemical Company and be granted power and authority to manage and operate said business, subject, however, to the control, ratification and approval of the Board of Directors of said company."

Mr. Farman, to your knowledge, was Mr. Lieben appointed manager of Schalk Chemical Company prior to that date?

A. Not to my knowledge, no, definitely not.

Mr. Hall: I didn't mention the date, your Honor, that is [323] the minutes of April 26, 1944.

Q. (By Mr. Hall): Well, did he act as manager prior to that date?

A. That was my understanding, yes, that he was the manager of this operation in Los Angeles, more of an understanding.

Q. Mr. Farman, on cross-examination you were asked some questions concerning the minutes of a meeting of the Board of Directors of Schalk Chemical Company on December 11, 1946, which are set

(Testimony of Gerald I. Farman.)

forth in Respondent's Exhibit J at Pages 280 to 282, and I call your attention to the bottom of Page 281, and the sentence which reads, "Director G. I. Farman called the attention of the Board to the fact that he had contracted an indebtedness of $16,000.00 for an automatic filling machine and an automatic crack filler," that is the end of the sentence.

Is that a correct statement? A. It is not.

Q. Will you tell us what is incorrect about it?

A. The amount of money contracted, $16,000.00 is very incorrect.

Q. Did you ever contract a $16,000.00 indebtedness for Schalk Chemical Company for machinery?

A. Not during that period.

Q. And during that period, what period do you mean? A. Of 1945, '46 or '47. [324]

Q. Is the description of the machines accurate?

A. On that automatic filling machine and the automatic crack filler, I imagine it means one machine. It is not properly worded but it is as accurate as an apprentice would get it, probably.

Q. Well, in 1945 and 1946 did you have anything to do with acquiring one or more machines?

A. I recommended the purchase of two or more machines, three machines, in fact, during those two years.

Q. Well, the first two, what machines were they?

A. An automatic, semi-automatic crack filling machine, and a semi-automatic packaging machine

(Testimony of Gerald I. Farman.)

for all sizes, all size packages up to one pound, starting with a three ounce size.

Q. What was the purchase price of those machines, if you recall, roughly?

A. Well, the purchase price of the one machine was $1500.00, the other machine I believe was about $1200.00. Those are the two main machines.

Q. Was one of those machines for use in Los Angeles?

A. One was for use here and is being used here, the other one was for use in Chicago.

Q. Now, on Page 282 of the same minutes, it states, "He," referring to Director G. I. Farman, "also suggested that it would be advisable to purchase an automatic filling machine for half-pound packages of Savabrush and that such a machine [325] would cost approximately $8000.00 installed."

Was that machine purchased? A. It was.

Q. When was it purchased approximately?

A. In 1946, I can't give you the exact date.

Q. Did you purchase that machine?

A. I did not, I recommended the purchase of that machine.

Q. Was that machine ever installed, to your knowledge?

A. That machine was not installed until 1948 after I went in as president.

Q. At that time was it installed and used?

A. It was.

(Testimony of Gerald I. Farman.)

The Court: Is that the machine that has previously been referred to as the one standing around in the warehouse for a year?

The Witness: Yes, sir.

Q. (By Mr. Hall): Mr. Farman, I refer you to the general ledger of Schalk Chemical Company for the year 1947, Account No. 03-C, and I call your attention to an entry on May 15, 1947, showing a debit of $8,058.00. Is that the price paid for the machine which you recommended that somebody else purchased, the fully automatic machine?

A. It is. [326]

Q. And that is the machine that was not installed until you took over, is that correct?

A. That is correct.

Q. On cross-examination, Mr. Farman, you were asked some questions regarding proposals in 1946 by you and Mrs. Farman to expand the plant and facilities of the company in Chicago.

Mr. Farman, I refer you to the minutes of the Board of Directors of Schalk Chemical Company dated July 24, 1946, which are set forth in Respondent's Exhibit J, Volume 4 of the Minute Books of Schalk Chemical Company at Pages 276 to 279, and the statement therein, "Thereupon Director Hazel I. Farman stated that she desired to present to the Board for consideration the matter of securing new quarters in Chicago, Illinois, or in that vicinity, for the reason that the present quarters would be inadequate in the event the Schalk Chem-

(Testimony of Gerald I. Farman.)

ical Company took on additional merchandise for sale. The matter was discussed by the Board for some time but no decision was arrived at."

I also refer you to the minutes of the Board of Directors of Schalk Chemical Company dated December 16, 1946, which appear in the same exhibit at Pages 280 to 282, and specifically Page 282 where it is stated, "The question of expansion of the plant facilities at Chicago and the matter of additional bonuses to the officers were also considered by the [327] meeting."

Now, Mr. Farman, was it in that period that the proposals to expand the facilities at the Schalk Chicago plant were made by you and Mrs. Farman?

A. It was.

Q. Now, you testified that it was possible at that time to purchase the Philco Building which was near the plant of Schalk in Chicago. As I recall it, your testimony was that that would have cost Schalk $118,000.00, is that correct?

A. That is correct.

Q. How much equity in your opinion would Schalk have realized from the sale of its then existing plant in 1946, approximately?

A. $42,000.00. If you would like me to explain it, I can do it, but $42,000.00.

Q. No; well, how much would it have cost Schalk a year to finance the balance of the purchase price of the building, to pay the balance of the purchase price?

(Testimony of Gerald I. Farman.)

A. I worked it out with the Central Manufacturing District, it was $6000.00 a year plus interest.

Q. And you had an arrangement for the financing at that time? A. I did.

Q. Who was that with?

A. Central Manufacturing District of Chicago.

Q. Mr. Farman, on cross-examination you testified, I believe, that Mr. Smith liked to work in the factory, mixing and packaging Schalk products, was that your testimony?

A. I believe it was.

Q. Of your own knowledge when if ever did this occur? A. Well, it occurred in 1946.

Q. Is that the only time you recall?

A. That is the time I recall.

Q. At that time did his working in the factory have anything to do with a shortage of employees?

A. Not at all.

Q. Mr. Farman, according to the books and records of Schalk Chemical Company, was your salary in 1945 and 1946 more or less than the salary paid to Mr. Smith? A. It was less.

Q. What was the salary paid to Mr. Smith?

A. $500.00 a month, as I recall it.

Q. In 1945 and 1946, is that correct?

A. Yes; that is right.

Q. During the same period was Mr. Fulmer's salary more or less than Mr. Smith's?

A. It was more than Mr. Smith's.

Q. Do you know how much it was?

(Testimony of Gerald I. Farman.)

A. As I recall it from memory it was $750.00 a month.

Q. Now, on cross-examination, Mr. Farman, you made [329] several statements concerning the operations and condition of Schalk Chemical Company prior to the year 1945. What was the source of your information in that regard?

A. Prior to 1945, as the husband of Mrs. Farman.

Q. Well, was this the result of conversations with Mrs. Farman?

A. Conversations, financial reports and other records that she would bring home or send to me wherever I was.

Q. Mr. Farman, I refer you to Respondent's Exhibit J, which is Volume 4 of the Minute Books of Schalk Chemical Company, at Page 221 and the memorandum which is inserted at that page which is a memorandum from H. C. Lieben to C. C. Colyear, President, dated January 25, 1941.

On Page 2 of that memorandum it states, "While our other specialty items have either held their own or enjoyed an increase, Double X Floor Cleaner has been declining rapidly since 1937. This has been due primarily to increased competition of lower priced items, use of new floor finishes and increased usage of sanding machines."

Now, Mr. Farman, is that expressive of the downward trend of the mainstay product, Double X, prior to the war, that you testified to last Thursday?

A. It is a very good explanation.

(Testimony of Gerald I. Farman.)

Q. In answer to a question by the Court, Mr. Farman, you stated that Schalk does not manufacture its products. I [330] would like you to explain a little further, what exactly Schalk does in putting out its products.

A. We purchase raw materials from manufacturers, formulate them, sometimes called blend them, formulate them by mixing them and package them, put them in packages of various sizes, if it is liquids it goes in cans, the dry powders go in either fiber cans or packages.

Q. The formulation is in accordance with a formula, is that correct?

A. Yes; it is followed——

Q. Now, on cross-examination you testified that the present management did not put a paint and varnish remover on the market until 1955 or 1956, notwithstanding that in 1946 you and Mrs. Farman recommended the product for the Schalk line.

Now, Mr. Farman, in 1946 how many national competitors were marketing a liquid paint and varnish remover?

A. Two, to my best knowledge and belief.

Q. Who were they?

A. Savagram Company of Boston and Wilson Imperial in New Jersey.

Q. Now, in 1948 and 1949 when you took over management of the company, how many national competitors were marketing a liquid paint and varnish remover?

A. Well, I would be glad to establish a minimum

(Testimony of Gerald I. Farman.)

figure of 20. I have records to substantiate that in my personal file. [331]

Q. Now, in 1948 when Schalk Chemical Company put tile cement on the market, how many competitors were making a similar product, if you know?

A. I would judge not over two or three.

Q. How about patch paste which was put on the market in 1950?

A. I believe, as I recall it, we had three; there were three on the market, but one had failed and pulled off. They were new and not proven.

Q. And tile paste in 1952?

A. There were about four on the market when we put that on the market.

Q. And Liquid Savabrush in 1953?

A. Very highly competitive, probably 20 or 30 of them.

Q. And Liquid Waxoff in 1954?

A. We were a leader, I mean there was one other, the Bruce Asphalt Tile Cleaner that was on the market at that time.

Q. And in 1956 Sure-X, X-It, and Do-X were put on the market by Schalk; what was the competitive position at that time?

A. Very highly competitive.

Q. Is that the paint and varnish remover?

A. Two of those are the paint and varnish removers.

Q. What is Do-X?

A. Do-X is a wall cleaner. [332]

(Testimony of Gerald I. Farman.)

Q. Now, in 1957, S-14 Spackling Compound was put on the market; what was the competition position at that time?

A. S-14 formulated with a polyvinyl is very new. I would say that we maybe have two or three competitors at this time, successful competitors.

Q. Now, Mr. Farman, what is the Schalk merchandiser?

A. That is a sales aid wherein we put representative stock in a retail store of all our items and it is a promotion item.

Q. Would you briefly describe what it is?

A. Well, it is made of cardboard, the stand is, it is seven inches wide, 24 inches long, and 27 inches high, and has shelves and at the top it says, Home Repair Products, and the products are placed on the shelves; if it a self-service merchandiser. It is actually, what it is, we call it a self-service merchandiser.

The Court: Is what you are talking about illustrated on the back page of Exhibit 14?

The Witness: It is, sir.

Q. (By Mr. Hall): When did Schalk first commence using the Schalk merchandiser?

A. It was in the early 50's, I don't recall the exact date.

Q. Prior to that time was there anything similar to [333] that used by Schalk Chemical Company?

A. Printer's Ink, and Sales Management, both published pictures of it and said it was the first thing like it in its field.

(Testimony of Gerald I. Farman.)

Q. Now, Mr. Farman, on cross-examination Mr. Gardner pointed out instances in 1947 as to which the minutes of the company show that new products were suggested to management by you and Mrs. Farman.

Prior to the time that the executive committee was disbanded, how were the proposals for new products handled?

A. They were handled in an executive committee meeting, if I understand your question properly.

Q. Were minutes or memoranda of those meetings kept? A. Yes.

Q. Who kept them? A. I did.

Q. When would they be prepared?

A. Well, we will say immediately after the meeting or the same day as the meeting.

The Clerk: Exhibit No. 32 for identification.

(The document above referred to was marked Petitioners' Exhibit No. 32 for identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you Petitioners' Exhibit No. 32 for identification and ask you if those are the minutes or [334] memorandum which you prepared? A. They are.

Q. Are those, most of them that are in that group in your handwriting?

A. Yes; they are.

Q. I should say all of the longhand memoranda are in your handwriting, is that correct?

A. That is right.

(Testimony of Gerald I. Farman.)

Q. And who was present usually at those meetings?

A. Mrs. Farman, Mr. Smith and myself.

Q. And, for example, there is a meeting on top here, September 27, 1945, 10:00 a.m.; when was the memorandum of the meeting prepared by you?

A. The same day, very definitely.

Q. That was your custom and practice?

A. That is my custom and practice.

Mr. Gardner: May I ask a question on voir dire, your Honor?

The Court: You may.

Voir Dire Examination

By Mr. Gardner:

Q. Petitioners' Exhibit No. 32 for identification are minutes of the executive committee meetings?

A. Yes.

Q. Are these the official minutes? [335]

A. I would say official minutes, yes.

Q. What makes them official?

A. It was a full committee meeting of the executive committee, was set up by the board of trustees or board of directors of the corporation.

Q. Were the minutes of the previous meeting read at the subsequent meeting?

A. They were often read, yes, sir.

Q. Were they read every time, sir?

A. I can't swear to it; I would say yes, I definitely would.

(Testimony of Gerald I. Farman.)

Q. Your testimony is these minutes were read at the next meeting? A. Yes; I did.

Q. You read the minutes?

A. I kept a file and read the minutes.

Q. Would they be passed on as correct, sir?

A. They never were passed on; Mr. Smith often got up and walked out.

Q. Who directed you to keep these minutes?

A. Why, I imagine I directed myself to keep them.

Mr. Gardner: I object to the introduction.

Mr. Hall: I haven't offered it yet. [336]

Redirect Examination
(Continued)

By Mr. Hall:

Q. Mr. Farman, as to what took place at these meetings, do you have any independent recollection apart from these memoranda that you made?

A. No; I haven't.

Mr. Hall: I offer them as Petitioners' Exhibit No. 32.

Mr. Gardner: I object to the introduction of these so-called minutes, your Honor. This is nothing more or less but a self-serving document prepared by the witness later and they have no official capacity whatsoever. It would be the same thing if he went home and wrote a note about the day's occurrence, naturally in the most favorable light to the witness.

Mr. Hall: Your Honor, they are memoranda of what he observed to transpire, and as memoranda

(Testimony of Gerald I. Farman.)

they are admissible. He has no direct recollection on the subject.

The Court: Were these contemporaneously kept?

The Witness: They were kept at every meeting.

The Court: How soon after the meeting did you prepare these?

The Witness: The same day.

The Court: I will admit it.

The Clerk: Petitioners' Exhibit No. 32.

(The document heretofore marked Petitioners' Exhibit No. 32 for identification was received in evidence.) [337]

The Court: What is the reason for the establishment of the executive committee?

The Witness: To try to eliminate the friction that was going on and to get co-operation and expansion of the company.

The Court: So there were difficulties with Mr. Smith prior to the formation of the executive committee?

The Witness: Yes, sir.

The Court: And that was an attempt to furnish a solution to the situation?

The Witness: Yes, sir.

Mr. Hall: Your Honor, I call your attention to Petitioners' Exhibit No. 15 on the question that you asked. This is a letter on the letterhead of Henry O. Wackerbarth. That letter, your Honor, states that in settlement of the controversy then existing there had been an agreement to set up or there was an agreement to set up the executive committee.

(Testimony of Gerald I. Farman.)

Q. (By Mr. Hall): Now, Mr. Farman, was there any general management and sales meeting in 1945 that you attended? A. Yes.

Q. Do you recall where that was held?

A. At the Biltmore Hotel here in Los Angeles.

Q. Approximately what time of the year?

A. It was either November or December, 1945.

Q. And do you recall who was present at that meeting? [338]

A. Well, Mrs. Farman and Mr. Smith, Mr. Fulmer, Mr. Lieben, Mr. Stebbans, myself, I recall.

Q. Who is Mr. Stebbans?

A. Mr. Stebbans is the owner now of his own advertising agency; I believe it was Honig-Cooper Company at that time. He is an advertising man.

Q. That was the advertising agency for Schalk at that time?

A. For Schalk Chemical Company at that time.

Q. And Mr. Stebbans was representing that agency at that time? A. That is correct.

Q. Did that conference last several days?

A. It lasted two or three days, yes.

Q. Was a memorandum made of that conference?

A. Yes, Mr. Fulmer prepared a memorandum of that conference.

Q. And do you know when he prepared that?

A. Well, yes, he made his notes during the conference and prepared it at Schalk Chemical Company's office, dictated it immediately after the meeting.

(Testimony of Gerald I. Farman.)

Q. Did he give you a copy of the memorandum?

A. Yes; he did.

The Clerk: Petitioners' Exhibit No. 33 for identification.

(The document above referred to was marked Petitioners' Exhibit No. 33 for [339] identification.)

Q. (By Mr. Hall): Mr. Farman, I hand you Petitioners' Exhibit No. 33 for identification and ask you if that is the memorandum which you referred to? A. It is.

Q. Have you read this memorandum recently?

A. No; I haven't recently, I don't believe.

Mr. Hall: Your Honor, shall we take a recess?

The Court: There will be a short recess.

(Short recess taken.)

Mr. Hall: I offer this document as Petitioners' Exhibit No. 33.

Mr. Gardner: If the Court please, the respondent objects to the introduction of that document solely for the reason that the document was prepared by Mr. Fulmer, and Mr. Fulmer is the person who should identify the document and possibly be interrogated on the completeness, accuracy, and when these statements were recorded.

Now, we have no opportunity to do that and the document is hearsay.

Mr. Hall: I appreciate that, your Honor; Mr. Fulmer lives in Iowa or some place back east and

(Testimony of Gerald I. Farman.)

I am just trying to save some time. Mr. Smith certainly has some idea as to the authenticity of that document. Now, if we want to spend time going over it when Mr. Smith testifies, fine. [340]

The Court: Was Mr. Farman present at the meeting covered by this document?

The Witness: I was, sir.

The Court: What is the purpose of the offer?

Mr. Hall: It shows the discussion of products, it shows some decision on products that were not thereafter produced by Schalk. It shows that there was an endeavor to set up new management policies and effect them.

The Court: I will admit it.

The Clerk: Exhibit No. 33.

(The document heretofore marked Petitioners' Exhibit No. 33 for identification was received in evidence.)

Mr. Hall: Your Honor, I refer to Paragraph 7 of the Stipulation of Facts, Paragraph 7 refers to a stipulation and agreement dated September 26, 1929. I call the Court's attention to the fact that that stipulation and agreement is contained in Respondent's Exhibit J, Volume 4 of the Minute Books of Schalk, set forth at Pages 67 to 88. The declaration of trust which is Petitioners' Exhibit No. 1 also is set forth in Respondent's Exhibit J at Pages 89 to 104, and there are also set forth in the Minute Books some collateral agreements relating to the declaration of trust and the stipulation and agree-

(Testimony of Gerald I. Farman.)

ment. Now, with regard to the executive committee, your Honor, I call the Court's attention to Page 271 which is part [341] of the minutes of the meeting of the Board of Directors on September 26, 1945; commencing on Page 271 is the resolution which sets up the executive committee and sets out the powers of the committee and voting rights and so forth. Mr. Gardner, will you stipulate that Mr. Stanley W. Guthrie is dead?

Mr. Gardner: So stipulate.

Mr. Hall: I will state for the record that Mr. Guthrie passed away in 1952. I call the Court's attention to the fact that as shown in Respondent's Exhibit J, that Mr. Guthrie attended practically every meeting, I think there were a couple that he didn't, of Schalk Chemical Company from May 18, 1942, up to the time of his death in 1952.

The first meeting which he attended is at Page 147 of Respondent's Exhibit K. Now, on cross-examination Mr. Gardner asked this witness some questions regarding whether the outstanding stock of Schalk Chemical Company was owned by Horace O. Smith, the father of Horace O. Smith, Jr.

The Clerk: Petitioners' Exhibit No. 34 for identification.

(The document above referred to was marked Petitioners' Exhibit No. 34 for identification.)

Mr. Hall: Petitioners' Exhibit No. 34 for identification is an amended inventory and appraisement in the matter of the Estate of Horace O.

(Testimony of Gerald I. Farman.)

Smith, Deceased, which amended inventory was filed on October 3, 1929. This is the copy, it is not a certified copy. [342]

The Court: I would conclude from Exhibit 1 and the matters referred to in Exhibit 1 that all of the shares of Schalk Chemical Company came from the estate of Mr. Smith, Senior.

Mr. Hall: That is not true, your Honor.

Mr. Gardner: That was my understanding.

Mr. Hall: But it is not true.

The Court: Very well, I will let you clarify the record, then.

Mr. Hall: I offer this as Petitioners' Exhibit No. 34.

Mr. Gardner: I have no objection.

The Court: Admitted.

(The document heretofore marked Petitioners' Exhibit No. 34 for identification was received in evidence.) [343]

* * *

Recross-Examination

By Mr. Gardner:

Q. Just two or three brief questions, Mr. Farman; Exhibit No. 10 shows the net profit before taxes for the Schalk Chemical Company from the period 1937 to 1957, does it not, sir?

A. It does.

Mr. Hall: May I ask Mr. Farman a question, Mr. Gardner?

(Testimony of Gerald I. Farman.)

Mr. Gardner: Surely.

Mr. Hall: Have you seen that before this time, Mr. Farman?

The Witness: No; I have not.

Mr. Hall: For the record, this exhibit was sponsored by Mr. Britton.

Mr. Gardner: Are you through?

Mr. Hall: Yes. [350]

Q. (By Mr. Gardner): Now, I believe that you testified that you took over in January of 1948, is that correct, Mr. Farman?

A. That is correct; January 15, 1948.

Q. And from that time on you ran the company, is that correct, sir? A. That is correct.

Mr. Hall: Your Honor, I object to this line of questioning as not being any part of the redirect examination, and any questions pertaining to the profit in those years should have been addressed to Mr. Britton who prepared that exhibit. Mr. Farman has not testified on it either in his direct examination or in his redirect examination.

Mr. Gardner: He has testified as to his qualification as a manager, if the Court please, and I believe that that is involved here.

The Court: You may continue.

Mr. Gardner: Thank you.

Q. (By Mr. Gardner): Now, I believe there was some testimony to the effect that Horace O. Smith, Jr., was making, what was it, $500.00 a month in 1945, sir, was that your testimony?

A. That was my testimony.

(Testimony of Gerald I. Farman.)

Q. $500.00? A. That was. [351]

Q. And that was as president and supervisor of Schalk, is that correct, sir?

A. Supervisor of the trust.

Q. Yes, and also president of Schalk, wasn't it?

A. As president of Schalk is all I know; I don't know anything about what he received as supervisor of the trust.

Mr. Hall: May I note for the record, your Honor, that the declaration of trust and the stipulation and agreement back of it provide that the trustee, the supervisor of the trust, shall receive no compensation as supervisor?

Mr. Gardner: Very good.

Q. (By Mr. Gardner): Now, then, also during the period that Horace O. Smith, Jr., was supervisor of the trust, as I understand it, there were dividends declared every year, is that correct, sir, up to 1947?

A. Yes; well, I can't, I assume they were, I am not positive, I haven't the records in front of me, but I believe that every year a dividend was paid.

Q. I believe you testified also that from the time you took over there have been no dividends, is that correct, sir? A. That is correct.

Q. Would you tell me, sir, what your salary was in 1948 when you took over as president of Schalk?

A. No; I cannot. [352]

Q. Was it as much as the prior president, Mr. Smith, Jr., had been receiving?

(Testimony of Gerald I. Farman.)

A. Yes; I imagine it was more than that, I don't know; I cannot tell you.

Q. All right, let's go on up to 1950; do you recall what your salary was, sir?

A. I don't recall it at all, sir.

Q. Do you recall what it is in 1958?

A. Yes.

Q. How much is it, sir?

A. My salary as president of Schalk Chemical Company is $12,000.00 a year.

Q. Is Mrs. Farman also an officer?

A. She is vice president and treasurer of the company.

Q. What is her salary, sir?

Mr. Hall: I object, your Honor, as not being proper examination at this time. Mr. Gardner could have covered these subjects earlier.

The Court: He may continue.

The Witness: Her salary at this time?

Q. (By Mr. Gardner): Yes.

A. As I recall, it is $450.00 a month.

Q. Now, has she received more than that during any period from 1948 to the end of 1958? [353]

A. More salary than that?

Q. Yes. A. Not as a salary.

Q. Does she receive any other income?

A. She has received bonuses.

Q. How much?

A. I have no idea; employee bonuses.

Q. Are they substantial bonuses?

A. Some years they were good bonuses, other

(Testimony of Gerald I. Farman.)

years we didn't even take a bonus when we paid the employees bonuses, we did not take bonuses ourselves.

Q. What would you consider a good bonus?

Mr. Hall: I object, your Honor, on the ground that this line of questioning is immaterial to the issues of this case. The question of reasonableness of salaries or reasonableness of bonuses or the fact that this management paid certain salaries or does not, or that it pays bonuses or it does not has nothing to do with this case. It is immaterial.

The Court: What is the purpose, Mr. Gardner?

Mr. Gardner: Well, if the Court please, in the first place it has nothing to do with this case as he says, yet this Exhibit 10, I note, is petitioners' exhibit, petitioner has introduced the profit throughout these years, petitioner has placed this in issue. Now, I would like to find out a little [354] more about this.

The Court: Placed what in issue?

Mr. Gardner: The years 1950, 1951, 1952 and up to 1957.

The Court: I think you are getting a bit remote, Mr. Gardner.

Mr. Gardner: Well, that may be; what I would like to do, your Honor, is show that this witness and Mrs. Farman are the only ones who are receiving anything from this corporation; dividends have been eliminated.

Mr. Hall: That is immaterial to the issues in this case, your Honor.

(Testimony of Gerald I. Farman.)

Mr. Gardner: And in that respect, your Honor, once again we are involved with a personal interest rather than a corporate interest. That is the issue in this case.

The Court: You have already established their present salaries, and the fact that no dividends have been declared has already been testified to. I think you have sufficiently exhausted that subject.

Mr. Gardner: All right. The only thing I haven't gotten into is the question of the bonuses and they could be substantial or not.

The Court: You may ask him what the range of the bonuses was.

Mr. Gardner: Thank you, your Honor. [355]

Q. (By Mr. Gardner): Would you state for the Court what is the range of the bonuses received by you and Mrs. Farman during the years——

A. They are set by Mrs. Farman and I never—they are set by the Board of Directors; I am sorry if I misunderstand——

The Court: Let's not quibble; what was the range of the bonuses that you and Mrs. Farman received?

The Witness: When we did receive bonuses, the highest I recall was $3,000.00 each; many of them, several of them probably a thousand and in some years we did not take any bonuses ourselves, the employees received bonuses.

Q. (By Mr. Gardner): But you have received as high as $3,000.00 each?

A. To my best recollection, yes, Mr. Gardner.

(Testimony of Gerald I. Farman.)

Mr. Gardner: If the Court please, I have one request of the Court; I have no further questions of this witness at this time. We attempted to arrange, that is, between counsel for petitioner and myself, a chance to share the wealth, so to speak, on the minute books over the week end. Counsel was very busy and was unable to relinquish the minute books. Now, I am going to attempt to study them tonight if counsel has no objection and I would like an opportunity to—I don't want this witness excused, I may want to recall him. I request the Court's permission at this time to do that. I can't say that my cross-examination is completed until I have gone over those minute books [356] carefully.

Mr. Hall: I take it, then, Mr. Gardner, you expect to go over until tomorrow anyway on the trial of this case?

Mr. Gardner: I should imagine it would, Mr. Hall.

Mr. Hall: I mean, you would proceed in the normal course, or are you asking for a recess until tomorrow morning?

Mr. Gardner: No; I am not asking for a recess. What I am asking is that this cross-examination right now be discontinued until such time as I can look those over tonight and then there may be no questions at all, your Honor.

Mr. Hall: It is satisfactory to me to have Mr. Gardner look over the minute books which are in evidence.

(Testimony of Gerald I. Farman.)

(Discussion at the bench off the record.)

Mr. Hall: I state for the record, your Honor, that Mr. Farman will be available throughout this trial and if there are any further questions, Mr. Gardner wants to put to him, we will be happy to have him resume the stand.

Further Redirect Examination

By Mr. Hall:

Q. Mr. Farman, were bonuses customarily paid by Schalk Chemical Company to the president and other officers of the company prior to 1948?

A. They were.

Q. In 1946, was a bonus paid to you as a vice president? A. It was.

Q. Do you recall the amount of that [357] bonus?

A. As I recall, it was $1,200.00.

Q. Was a similar bonus paid to Mrs. Farman at that time? A. It was.

Q. Mr. Farman, I show you Respondent's Exhibit K which is Volume 5 of the Minute Books of Schalk Chemical Company, minutes of January 15, 1948, meeting of the Board of Directors, Page 27 of the volume, where it states, "Resolved that the salary of the president, G. I. Farman, shall be $500.00 per month commencing January 15, 1948."

Does that refresh your memory as to what your salary was?

A. It does; I didn't know what my salary was.

Mr. Hall: I have no further questions.

Mr. Gardner: I have no further questions at this time.

Mr. Hall: Then I have no further questions at this time.

(Witness excused.)

Mr. Hall: I call Mrs. Baker.

PATRICIA FARMAN BAKER

a witness called by and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address, please?

The Witness: Patricia Farman Baker, 94 Esperenza Street, Sierra Madre.

Direct Examination

By Mr. Hall:

Q. Mrs. Baker, are you one of the petitioners in this [358] proceeding? A. I am.

Q. We have here as Petitioners' Exhibit 1 a declaration of trust in which is named a Patricia Smith; are you Patricia Smith? A. Yes, sir.

Q. Mrs. Baker, I hand you Petitioners' Exhibit 16 which is an agreement dated January 15, 1948, between Horace O. Smith, Jr., First Party, and Hazel I. Farman, Evelyn Smith Marlowe and Patricia Farman Baker.

This agreement I will refer to as the settlement

(Testimony of Patricia Farman Baker.)

agreement. Did you sign that agreement, Mrs. Baker? A. Yes; I did.

Q. Does your signature appear on there?

A. Yes, it does.

Q. Now, Petitioners' Exhibit No. 16, Mrs. Baker, states that $25,000.00 was paid to Mr. Smith at the time of that agreement. Did you pay any part of the $25,000.00? A. Yes.

Q. How much? A. $5,000.00.

Q. And where did the $5,000.00 come from, Mrs. Baker?

A. We borrowed it from my father-in-law, Walker H. Baker.

Q. By "we," who do you mean? [359]

A. Mr. Baker.

Q. John Harvey Baker?

A. That is right.

Q. He is also a petitioner in this proceeding, is that correct? A. Yes.

Q. When did you marry Mr. Baker?

A. In 1943.

Q. 1943? A. Yes.

Q. Now, the $5,000.00 was borrowed, you say?

A. Yes.

Q. From whom?

A. Dr. Baker, Mr. Baker's father.

Q. Did you give Dr. Baker a note for the loan?

A. We did.

Q. Was the note later repaid? A. It was.

Q. Do you recall when it was repaid?

A. 1950, '51.

(Testimony of Patricia Farman Baker.)

Q. Do you recall what funds you used to repay that note, where you got the funds that you used to repay that?

A. I suppose from our mutual, what we had together, I don't recall exactly.

The Clerk: Petitioners' Exhibit 36 for identification. [360]

(The document above referred to was marked Petitioners' Exhibit No. 36 for identification.)

Q. (By Mr. Hall): Mrs. Baker, I hand you Petitioners' Exhibit No. 36 for identification, and ask you if this is the copy of the note that you gave to Dr. Baker? A. Yes; it is.

Q. When this note was repaid, was the original returned to you?

A. I don't know what happened to the original. I imagine it was destroyed.

Q. Well, have you conducted a search for it?

A. Yes; I have.

Q. But you were unable to find it?

A. I couldn't find it.

Mr. Hall: I will say for the record, your Honor, that this came from the files in the law firm of which I am privileged to be a member. I offer this as Petitioners' Exhibit No. 36.

Mr. Malone: No objection, your Honor.

The Court: Admitted.

(The document heretofore marked Petitioners' Exhibit No. 36 for identification was received in evidence.)

(Testimony of Patricia Farman Baker.)

Q. (By Mr. Hall): Are you working at the present time, Mrs. Baker? [361] A. Yes.

Q. Where are you employed?

A. Schalk Chemical Company.

Q. How long have you been employed at Schalk Chemical Company? A. Since 1950, '51.

Q. In what capacity are you employed by Schalk Chemical Company?

A. General office work.

Q. By general office, what duties do you have?

A. Well, I do a little of everything, purchasing, bookkeeping, a little bookkeeping, credit, posting, just about everything.

Q. Mrs. Baker, I hand you again Petitioners' Exhibit No. 16 which was the settlement agreement with Mr. Smith. Would you state for the Court what was your, what your purpose was in entering into that agreement?

A. Well, my purpose was, and it was shared by my mother and sister, was to end the dissension which had gone on for several years over the policies and management of the corporation, and so that the company could prosper and grow.

Q. Did you at any time have any desire to acquire any part of Mr. Smith's stock interest?

A. Well, hardly. It would have amounted to approximately, I guess it would have amounted to one-thirtieth [362] of my stock interest.

Q. One-thirtieth of what, Mrs. Baker?

A. Well, it would have added that much to my

(Testimony of Patricia Farman Baker.)

stock interest and he could have kept his stock, I wasn't interested in it in the least.

Q. Now, the $5,000.00 that you paid to Mr. Smith, did you expect to receive that back, Mrs. Baker?

A. Well, yes; I thought—it was just like loaning it to the corporation, that it should be paid back when the company was back on its feet.

Mr. Hall: You may examine.

Cross-Examination

By Mr. Malone:

Q. Mrs. Baker, I believe you stated that you are a petitioner in this case, is that true?

A. That is true.

Q. Do you have an ownership interest in the Schalk Chemical Company? A. Yes; I do.

Q. And what is that interest?

A. One-sixteenth, I believe it is.

Q. One-sixth? A. One-sixteenth.

Q. One-sixteenth?

A. I think that is correct; I am not sure. [363]

Q. Well, how many shares of stock in the company do you own? Do you know how much that is?

A. I don't——

Mr. Hall: Your Honor, we will stipulate that Mrs. Baker owns 16,667 shares.

Q. (By Mr. Malone): Mrs. Baker, do you know how many shares of stock in the Schalk Chemical Company are outstanding?

A. That same amount that I have.

(Testimony of Patricia Farman Baker.)

Q. Well, do you know who else owns interest in the Schalk Chemical Company?

A. My mother and my sister.

Q. Your sister, does she own the same amount of interest that you own? A. That is right.

Q. How much does your mother own?

A. My mother owns 50 per cent.

Q. Fifty per cent, do you mean she owns 50,000 shares? A. I suppose so, yes.

Q. Do you know how much stock is outstanding of the corporation, how much the total amount of stock?

Mr. Hall: I stipulated, your Honor.

The Court: He is entitled to find out from this witness what she knows.

The Witness: 16,000, the same amount that I have, [364] 16,666 shares.

Q. That is the amount of stock that you understand to be outstanding for Schalk Chemical Company? A. Yes.

Q. How long have you owned this stock, Mrs. Baker? A. Well, I have always had it.

Q. That is to say you have always had an interest in the Schalk Chemical Company?

A. That's right. I have always had an interest.

Q. Has it always been in this amount?

A. No; when my grandmother died, my paternal grandmother, the trust was still in existence and I believe that part of that was divided between my brother and my sister or that all of it was divided between my brother and my sister and myself.

(Testimony of Patricia Farman Baker.)

Q. Do you remember how much this interest was?

A. The same amount as we each had, each 16,-666.

Q. You stated—have you depended upon Schalk for your livelihood by way of salary or dividends?

A. By way of salary.

Q. For how long?

A. Since I have been working there, 1951.

Q. Is that 1950 or 1951?

A. It could have been 1950 or it could have been 1951; it was approximately around there.

Q. Well, before 1950, you did not work for Schalk in [365] any way? A. No.

Q. Were you acquainted with the business?

A. Yes.

Q. In what respect?

A. Well, we were living at home at the time. This was when I was married and I was very well acquainted with what was going on.

Q. Well, what do you mean by that, now? Did you go down to the business every day?

A. Not every day; on occasion.

Q. Did you go down at all?

A. On occasion.

Q. What were those occasions?

A. Oh, I went down with my mother when she went down, I don't know that there was any particular occasion to go.

Q. What did you do when you went down?

A. When I went?

(Testimony of Patricia Farman Baker.)

Q. Yes.

A. I don't remember that; I just went with my mother and stayed and waited for her.

Q. I see. At the times that you went down to the company you sat in the waiting room until your mother was through?

A. There isn't a waiting room as such; I just found a [366] chair and sat down in the office.

Q. You did not have any business, then, to do when you went down there?

A. I wasn't working; I was married then.

Q. Did you have anything at all that you would be inquiring about, was the purpose strictly to accompany your mother or was it for any other purpose of your own?

A. It was not for any particular purpose of my own other than I wanted to sort of be a, help Mother if she needed it, she wasn't received very well at that time down there.

Q. Do you know why your mother went down there?

A. She was working there for awhile.

Q. What periods were those?

A. Let's see, well, 1946, 1945 and '46 and '47.

Q. Well, prior to the time you were employed by Schalk, you received money from the company by way of dividends? A. Yes; I did.

Q. Did you receive this money regularly?

A. Yes.

Q. Every year you received a dividend?

A. I believe it was every year.

(Testimony of Patricia Farman Baker.)

Q. Do you recall about what your extent of the share of the dividends were? A. No; I don't.

Q. Was it a substantial amount? [367]

A. It was apportionate to my——

Q. Your interest? A. My interest.

Q. Was it a substantial amount, was it sufficient for you to live on? A. Well, no.

Q. Now, let's get this down to years. Now, for example, during 1949 did you receive dividends?

A. 1949, no.

Q. Well, now, in 1948 did you receive dividends, do you recall?

A. I don't believe so; I don't recall.

Q. 1947, did you receive dividends?

A. I don't think so.

Q. 1946, did you receive dividends?

A. Yes.

Q. Was it a substantial amount?

A. I believe it was; I couldn't say exactly how much.

Q. Was your share of the dividends more than $2,000.00? A. I couldn't say.

Q. Was it less than $2,000.00?

A. I don't know, I really don't; I would have to check.

Q. Well, during the year 1946, you were married at that time, were you not? A. Yes. [368]

Q. Was your husband providing your income at that time? A. Yes.

Q. Were you depending upon Schalk for any income at all?

(Testimony of Patricia Farman Baker.)

A. No, only—no, just the dividends, I wasn't depending on them as such, I couldn't have lived on them.

Q. Were you looking forward to receiving them?

A. Well, it is always nice to receive them.

Q. How about the year 1945, did you receive dividends?

A. I don't remember, I really don't; we probably did receive them every year for a long time.

Q. Well, in 1943, did you receive them, let's say before you were married did you receive dividends?

A. Yes.

Q. Do you recall the amounts of those dividends?

A. No; I don't; it didn't do me much good before I was married because then I was not of age.

Q. What was your age in 1943, may I ask?

A. 1943, I was 19.

Q. In 1944 you would be 20; 1947, what would be your age? A. 1947, 24—23.

Q. You would be 22, wouldn't you?

A. 22, all right.

Q. While you were married you did not depend upon Schalk for your source of income, is that correct? A. That is correct. [369]

Q. Do you know of your own personal knowledge as to the other members of your family, did they depend upon Schalk for their income?

A. No.

Q. What about Mr. Smith; do you know if he depended upon the company for his income?

(Testimony of Patricia Farman Baker.)

A. I suppose he did.

Q. And your sister, Evelyn Brown?

A. She was married.

Q. She did not depend upon Schalk for her source of income? A. No.

Q. What about your mother; did she depend upon the company?

A. Mother depended a great deal on it in some ways.

Q. What ways do you mean?

A. Well, I mean—I am sorry, I made a mistake. Mother didn't need—she didn't depend on it.

Q. She did not depend on it? A. No.

Q. Was she independently wealthy?

A. No.

Q. What did she depend on for her living?

A. My father.

Q. Who is that? [370] A. Mr. Farman.

Q. Is Mr. Farman your father?

A. He is my legal father.

Q. I see. Were you adopted?

A. Yes; I was.

Q. Do you know when that took place?

A. It was shortly after they were married. I was eight or nine or ten.

Q. You were quite a young child at that time?

A. Yes; I was.

Q. Well, have you ever been an officer of the Schalk Chemical Company? A. No; I haven't.

Q. Just an employee? A. That is right.

Q. Have you ever been a director? A. No.

(Testimony of Patricia Farman Baker.)

Q. What is your acquaintanceship with the business other than as an employee? Have you ever had a chance to look into the books and records of the business? A. Yes, I have.

Q. You have. When did you do this?

A. Well, I do it quite frequently.

Q. You mean you do it now?

A. Yes; I do a lot of the posting; I make out the [371] checks, occasionally I read a financial statement, but not always.

Q. You say you read a financial statement?

A. I look at one.

Q. What do you look at on the financial statement? A. I look at our profit.

Q. The net profit? A. Yes.

Q. Are there any other things to look at on a financial statement?

A. What we have spent for advertising, what the overhead is.

Q. Do you make a general analysis of the financial statement? A. Not as—no.

Q. Can you tell by looking at a financial statement the condition that the business might be in?

A. Well, I can tell whether it is making money or not.

Q. By the net profit? A. That is right.

Q. Can you tell whether a business is solvent by looking at its financial statement? A. Yes.

Q. You can, and what do you look at to determine whether the business is solvent or not? [372]

A. I am sorry——

(Testimony of Patricia Farman Baker.)

Q. You look to see whether there is a net profit or not, isn't that about it?

A. Yes; I look to see if there is a net profit.

Q. But actually you are not able to tell whether the business is solvent or not by looking at its financial statement?

Mr. Hall: I object, your Honor; the question is argumentative. The witness has stated she doesn't know really.

The Court: She may answer.

The Witness: Would you state the question again, please?

Q. (By Mr. Malone): Well, when you look at the financial statement, isn't it the case that you just look to see whether there is a profit or not; you are not able to tell whether its business is solvent or not?

A. Well, I am down there enough; I have a pretty good idea of whether we are solvent or not. The bill collectors aren't coming around; we have a good rating in D and B.

Q. Are those the things which to you mean the company is solvent?

The Court: Are you asking her about her present knowledge of the enterprise or are you, do you want to find out what she knew about it at the time these transactions were entered into?

Mr. Malone: I am trying to test the basis for the [373] witness' belief as to her ability to evaluate the business, your Honor. She may do that as of now or as of any other time.

(Testimony of Patricia Farman Baker.)

The Court: I think you would make more progress if you would put your questions to her in terms of what she knew at that time.

Mr. Malone: Thank you, your Honor.

Q. (By Mr. Malone): Now, Mrs. Baker, did you know in 1947 whether the business was solvent or not?

A. In 1947 we lost money. I know this—I don't know, and I know we lost money in 1940, but at that time I was young and money didn't mean too much at that particular time as far as I was concerned. I was unhappy that the company had lost money.

Q. Did you know that the business was solvent, I believe that was my question.

Mr. Hall That calls for a conclusion of the witness.

The Court: I don't know what counsel means by the use of the word solvent anyhow. Suppose you reframe your question.

Mr. Malone: All right.

Q. (By Mr. Malone): Mrs. Baker, in 1947, did you know whether the corporation had sufficient current assets to meet its current liabilities?

A. I don't know. [374]

Q. Did you know whether the corporation had sufficient current assets to meet its current liabilities in 1946?

A. I don't know. My brother was in complete control at that time and he didn't share anything with any of us.

(Testimony of Patricia Farman Baker.)

Q. Did you ever look at any of the books and records at that time? A. No; I did not.

Q. Well, really then, you didn't know what was going on in the corporation financially, did you?

A. No; I didn't. [375]

* * *

Redirect Examination

By Mr. Hall:

Q. Mrs. Baker, did you understand Mr. Malone's question on cross-examination when he asked you what was the outstanding stock of Schalk Chemical Company? A. No; I did not.

Q. You did not understand it?

A. I did not understand it.

Q. What is the outstanding stock of Schalk Chemical Company?

A. 100,000 shares; it was until the termination of the trust.

Q. And what has it been since the termination of the trust?

A. That less the stock acquired from my brother.

Q. Now, prior to the date of your marriage, to whom [376] were the dividends paid that we will say belonged to you?

A. To the guardian; to my guardian.

Q. Who was that? A. Mr. Colyear.

Q. Curtis C. Colyear? A. That is right.

Q. He was also the supervisor of the trust, is that correct? A. That is right.

(Testimony of Patricia Farman Baker.)

Q. Mr. Malone asked you some questions regarding your knowledge of the affairs of Schalk Chemical Company prior to the time that you were employed by Schalk Chemical Company. Now, as I recall, you said you were employed in 1950 or 1951.

A. Yes.

Q. Prior to 1948 did you participate in any meetings between the family and Mr. Smith?

A. Yes; from 1955 on.

Q. What was the answer, please? A. Yes.

Q. What year did you say?

A. From 1955 on, after 1955.

Q. Do you mean 1945?

A. I am sorry, 1945.

Q. And could you approximate the number of meetings that were held between the family and Mr. Smith, and say what [377] period of time you are talking about? A. Well, I——

Q. Just roughly.

A. Oh, there must have been many, many meetings, numerous meetings.

Q. Would you say there were more than 50 meetings in the period 1945 to 1948?

A. Oh, yes; at least that many.

Q. Where were these meetings held normally?

A. Various places, at home, at my parents' home, at Mr. Guthrie's office.

Q. And were you living with Mr. and Mrs. Farman in 1945? A. Yes.

Q. Was your husband also living with them?

A. Yes.

(Testimony of Patricia Farman Baker.)

Q. And there were meetings held at the home, is that correct? A. That is right.

Q. And what did these meetings concern?

A. Well, they concerned trying to reach some kind of a settlement with Mr. Smith, my brother, or to get him, to have him co-operate with the family and all of us in general.

Q. Were the affairs of the corporation discussed at those meetings? [378] A. Certainly.

Q. What matters were discussed at those meetings affecting the corporation?

A. New products, the need for new products, a building which was needed in the east because ours was not adequate, and the business in general.

Q. And there were meetings in Mr. Guthrie's office, is that correct? A. Yes.

Mr. Hall: You may examine.

Recross-Examination

By Mr. Malone:

Q. Now, Mrs. Baker, in regard to these meetings, they were held to discuss the matters involved as to management; was there any discussion at these meetings as to whether or not you might sell your interest in the company?

A. I don't remember.

Q. Were there any discussions at these meetings regarding the sale of the company completely to outsiders, for example?

A. There could have been, but I couldn't say definitely that there were.

(Testimony of Patricia Farman Baker.)

Q. Well, can you say that there were not?

A. No; I don't remember this part of it.

Q. These meetings that you had, did you participate [379] in them?

A. No; not to any extent.

Q. Did you make any suggestions?

A. I am sorry; we all had ideas of products that we thought should possibly be considered. My ex-husband did, my sister did, and I was quite young at the time but even I did.

Q. You had ideas?

A. Ideas, yes; I can't think of what they were right now; I did.

Q. Well, in regard to the—what was the consequence of these meetings, were you able to work out an arrangement that changed the company management?

A. No. My brother would not co-operate with any of us at the time. He wanted full control which he had and exercised.

Q. Did you take any action subsequent to these meetings with respect to instituting litigation in this case?

A. There was—we brought action against him, yes.

Q. There was a suit filed? A. Yes.

Q. Were you a party to that suit?

A. I don't know what you mean by party to it.

Q. Were you involved, were you named in the action?

A. I don't recall whether I was or not, but I

(Testimony of Patricia Farman Baker.)

was a party to it in—how can I word it, I was for it at the time.

Q. Did you suggest it at the outset? [380]

A. Did I suggest it?

Q. Yes.

A. No; I was, it was a mutual thing that we agreed to.

Q. Who suggested it? A. I don't recall.

Q. You don't recall, but you did not?

A. No.

Q. When did this occur, these discussions at which time there was talk about instituting this action? A. I don't remember.

Q. Was it in 1947? A. I don't remember.

Q. Was it in 1946?

A. I don't remember the year, sir, that it happened, that we brought the suit, I am sorry, I can't say.

Q. But you did have meetings before the suit was brought at which you were in attendance?

A. We had meetings from 1955, on—1945 on, I am sorry.

Q. Did you have any suggestions as to the matters that should be brought up in the litigation which subsequently followed? A. No.

Q. Do you know what matters were brought up in the litigation?

A. I am sorry, I don't. [381]

Q. Do you know that there were eleven causes of action filed against Mr. Smith?

A. I am sorry, my memory isn't that good.

(Testimony of Patricia Farman Baker.)

Q. You do not know, do you have any idea how many causes of action were filed?

A. Did you say eleven were?

Q. I asked you if you know whether eleven were or not.

A. No, I don't recall the number of actions.

Q. Do you know that it was more than one action, more than one cause of action was alleged in the complaint? A. I don't know, sir.

Q. Do you know whether Schalk Chemical Company was named in the complaint?

A. I don't know that, either.

Q. Did you sign the complaint?

A. I imagine I did.

Q. Well, at that time were you familiar with its contents?

A. At that time I probably was, yes, I don't sign things unless I am familiar with the contents.

Q. Then you had read the complaint?

A. Yes, I had.

Q. At that time you knew what was in it?

A. That is right.

Q. Were any of the matters complained in the complaint [382] at the time, were any of them suggested by you as causes of action that should be brought? A. I doubt it.

Q. Who was it that suggested the causes of action?

A. I have no idea; we had attorneys, they probably suggested it.

(Testimony of Patricia Farman Baker.)

Q. Did Mr. Farman suggest any of the matters that should be brought in the suit?

A. I don't know.

Q. Was he present at any of these meetings?

A. Yes, he was.

Q. Did he take an active part?

A. Yes, he did.

Q. In respect to making suggestions, did he do that as to what should be brought in the complaint against Mr. Smith?

A. He probably made suggestions, but we had to agree to them.

Q. Did you make any of these suggestions?

A. No, I did not.

Q. Do you recall having made any suggestions to Mr. Farman?

A. I don't recall; possibly I did, I don't know, I can't recall.

Q. Well, the case was really, you were looking to him for advice and counsel in that respect, weren't you following [383] his advice as to what should be raised as to your complaint?

A. I follow my father's advice, but I also have a mind of my own, and I do what I think is right.

Q. Another question, Mrs. Baker, prior to 1945 did you have any business experience with respect to any kind of industry or business?

A. Prior to 1945?

Q. Yes.

A. Well, I got married at 19 and I was just out of school.

(Testimony of Patricia Farman Baker.)

Q. And during the time you lived with your parents and your husband, your husband provided your living for you, is that correct?

A. That is correct.

Q. Now, prior to 1947 have you had any business experience?

A. Prior to 1947 I helped my husband only in typing reports for him and in his things I could do for him at home is all.

Q. What was his work?

A. He was an engineer.

Q. I see. For whom was he employed?

A. Well, he first, when I married him, was working for Aerojet Engineering, then he went into the Navy, was in the Navy for a year and a half, or a year, then he came out and [384] went to work for Elcon, I believe it is, Elcon Manufacturing Company.

* * *

Mr. Hall: Mr. Bradley.

EARL F. BRADLEY

a witness called by and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address for the record, please?

The Witness: Earl F. Bradley, 2101 Medial Drive, Los Angeles 49.

(Testimony of Earl F. Bradley.)

Direct Examination

By Mr. Hall:

Q. Mr. Bradley, what is your occupation, please?

A. I am a salesman for Schalk Sales Company.

Q. How long have you been employed by Schalk Sales Company? A. Thirty-five years.

Q. Do you mean Schalk Sales Company or Schalk Chemical Company?

A. Schalk Chemical Company.

Q. You have been employed by Schalk Chemical Company for 35 years? [385] A. Yes, sir.

Q. As a salesman? A. Yes, sir.

Q. Do you have a territory today, Mr. Bradley?

A. Yes.

Q. What territory is that?

A. I work the Los Angeles area and Arizona.

Q. Los Angeles and Arizona?

A. Yes, and San Diego.

Q. How long have you had that territory?

A. Since 1947.

Q. Since 1947? A. Yes.

Q. Now, prior to 1947 what territory did you handle for Schalk Chemical Company?

A. I worked all the middle western states.

Q. Did that territory have a name?

A. Central District, I think they called it; it was from Chicago to Minneapolis.

Q. What states did the Central District cover?

A. Illinois, Wisconsin, Minnesota, North Dakota,

(Testimony of Earl F. Bradley.)

South Dakota, Nebraska and Missouri, part of Indiana, too.

Q. Prior to that time, prior to the time that you came here to take over the Los Angeles-Arizona territory, how long had you had the territory in the mid-west? [386] A. From 1923 to 1947.

Q. 1923 is the year you were first employed by Schalk Chemical Company?

A. I started in March.

Q. Now, in servicing or performing your sales work for Schalk Chemical Company in this mid-west area prior to 1947, what were your duties, Mr. Bradley?

A. I called on paint, hardware and lumber yards, paint jobbers, paint manufacturers, hardware jobbers and lumber yards, with the Schalk products.

Q. And that necessitated, did it, being on the road quite a bit?

A. Quite a bit, I was probably on the road half the time.

Q. Where did you reside at that time?

A. Chicago.

Q. You resided in Chicago at all times prior to 1947? A. Yes.

Q. And you would be on the road approximately how long each year?

A. Oh, probably seven months each year, or six months.

Q. How long would it take you to make the circuit of your territory?

A. It would all depend on what trip you would

(Testimony of Earl F. Bradley.)

make, some trips would take two weeks, some would take three weeks, [387] when I went to Chicago, to Minneapolis, it would take about two weeks, up to Kansas City would take longer, about three weeks.

Q. How many times a year would you contact your accounts? A. About three times.

Q. In other words, you were on the road most of the year but you weren't off the road for six months, were you, sir?

A. Well, when I was off the road I worked around Chicago.

Q. I see. Now, at any time during your employment with Schalk Chemical Company have you been assigned to work not as a salesman but work in the factory in Chicago? A. Yes.

Q. When was that?

A. That was in 1946, I think, I was in the factory for about four or five months, probably six months.

Q. What circumstances existed in Chicago at that time that occasioned the fact that you were working in the factory?

A. There was a terrific backlog of orders in the company, there was a shortage of help in the factory. There didn't seem to be any point in going out trying to get more business when you didn't have material to fill the orders that you had on hand.

Q. And how long were you working in the factory at [388] that time?

A. As near as I can recall, it was about six months.

Q. What did you do in the factory?

(Testimony of Earl F. Bradley.)

A. Well, we packed material.

Q. What did you do personally?

A. Well, I kind of worked as a team there with two other salesmen and we run the machines, the automatic Double X machine, we called it, then we had to help in the shipping, we were generally busy.

Q. Well, did you work every day, Mr. Bradley?

A. Every day, yes, not a full eight hours every day.

Q. Well, would you work only a half a day?

A. Sometimes we worked a half a day.

Q. Then would you go home? A. Yes.

Q. Were attempts being made at that time to secure materials to round out the production, make it full production?

A. Well, there was a manager in charge, I imagine he did, I don't know, he was in the factory most of the time when we were there, what he would do at other times I don't know.

Q. Well, what about orders you had obtained, Mr. Bradley, were they current? A. Oh, yes.

Q. They were not backlog?

A. Well, the orders that came in were backlogged. [389]

Q. How far were your orders backlogged?

A. Some six or seven months, some of them were almost a year old.

Q. Prior to that time what had been your experience concerning the amount of time elapsing between the time that you placed an order and presented it to the company and the time the company

(Testimony of Earl F. Bradley.)

filled it? A. Before this backlog?

Q. Yes.

A. They would generally go out the same day.

Q. Now, while you were working in the factory did you observe the receipt of orders for shipment of products?

A. We would see them come in in the morning.

Q. What was done with those orders?

A. They would stamp them, the date received, and then put them in the drawer, put them on the bottom of the pile.

Q. How many orders were accumulated in this pile that you mentioned?

A. I think there were over 700, I know we counted them once and there was close to a thousand, I think.

Q. This was in 1945 or 1946? A. Yes.

Q. After the expiration of this period, you went back on the road, is that correct? A. Yes. [390]

Q. And at that time there was plenty of products to sell, is that correct? A. Yes.

Q. Now, you have had over 35 years of experience selling the Schalk lines, as I understand it?

A. Yes.

Q. Prior to World War II what was your opinion of the Schalk line?

A. Well, I was very enthusiastic about it, good products, they did a good job, they were well received.

Q. Did this opinion change?

(Testimony of Earl F. Bradley.)

A. In reference to the products, no.

Q. Well, was there any trend that you observed?

A. Well, I noticed, I began to notice that the sale of Double X was dropping off.

Q. When was this?

A. Probably started some time in the late 30's.

Q. Was this of concern to you personally?

A. Yes, it was.

Q. Why?

A. Well, it was our leading article in money value, point of sale, it was the item that the salesmen could do the biggest volume with and make the most money out of.

Q. What market conditions prompted the decline, in your opinion? [391]

A. It was a slowly changing picture, sanding machines, the sanding machine manufacturers began to put sanding machines in paint and hardware stores for rental, the homes began to put in wall-to-wall carpeting, eliminating the use of recleaning the floor, and asphalt tile came along, it was a picture that has changed considerably in the last few years; where there once was ten wooden floors in a ten room home, now there would be only one or two.

Q. What was your own opinion in this field?

A. I thought that we would have to have something to boost the sales in Double X, we needed new products, something to take its place.

Q. Did you recommend any new products to Schalk?

(Testimony of Earl F. Bradley.)

A. Specifically I mentioned one or two to Mr. Fulmer who was in charge of the Chicago office.

Q. When was this, Mr. Bradley?

A. I don't know the exact year, but when I noticed the sale of Double X began to bog down.

Q. Was any action taken on your recommendations?

A. Well, I don't know, when I would mention these things to Mr. Fulmer he would say well, I will take it up with the main office.

Q. Well, were any of the products you suggested marketed?

A. A long time after I recommended them. [392]

Q. By Schalk Chemical Company? A. Yes.

Q. What products were they?

A. One was a wallpaper grease spot remover, a plastic pencil, the pencil for filling cracks in walls made out of plastic material, called a plastic pencil.

Q. Were the market conditions, as far as Schalk is concerned, changed by World War II?

A. I don't know quite what you mean.

Q. Well, was your personal concern with the situation changed by reason of World War II?

A. Well, I felt if some change, if some new products hadn't been offered that with Double X drying up you wouldn't have anything to sell during the war or after the war.

Q. Did the war change the picture in your opinion?

A. Oh, yes, the war helped in this way, that a lot of jobbers, people we hadn't sold anything to before

(Testimony of Earl F. Bradley.)

were trying to find merchandise to sell, so they were trying to stock our items. For instance, I had a couple of ship chandlers that never sold anything of ours until the war came along, and then they were desparate for items to sell so they were trying to get our line.

Q. You testified earlier there was a shortage of materials in 1945 and 1946; was there a shortage of any other essential supplies? [393]

A. Shipping containers.

Q. What do you mean by shipping containers?

A. The cardboard box that you put the merchandise in.

Q. How about cans?

A. There was a shortage of cans, too.

Q. Did you assist in procuring cans for Schalk Chemical Company in 1946?

A. I did in an indirect way.

Q. What did you do in that regard?

A. I took Mr. Farman up to the American Can Company in Chicago and introduced him to a man who had been a former associate of mine; I worked for the American Can Company, and told him the situation we were in and he got some cans for us.

Q. When did you work for American Can Company? A. 1921 or 1922.

(Testimony of Earl F. Bradley.)

Cross-Examination

By Mr. Gardner:

Q. Mr. Bradley, referring to the period 1946 when you worked in the Chicago plant, that was a rather unusual situation, wasn't it, sir?

A. It was.

Q. What was the reason that there was such a backlog of orders, could you tell me, sir?

A. We didn't have the material to fill them; they were coming in faster than you could get raw material to [394] formulate these products, I guess.

Q. You were having difficulty obtaining the raw materials, sir, and you would place these orders, I suppose many months back, but still hadn't received the shipment or fulfillment of your orders, is that right? A. That's right.

Q. That was, in other words, would you say, sir, that was a situation that was common in 1946?

A. I imagine.

Q. Everybody was having difficulty obtaining supplies, weren't they, sir?

A. I imagine. [395]

* * *

Mr. Gardner: Mr. Smith.

HORACE O. SMITH, JR.

a witness called by and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

The Clerk: Will you state your name and address, please?

The Witness: Horace O. Smith, Jr., 1941 New York Drive, Altadena.

Direct Examination

By Mr. Gardner:

Q. Mr. Smith, you are the son of Horace O. Smith, Sr., are you not? A. Right.

Q. And at the date of your father's death, how old were you, sir? A. About 17.

Q. Did you know Mr. Colyear?

A. Yes, sir.

Q. Did you know him at that time? [396]

A. Yes.

Q. How long had you known Mr. Colyear in 1928 when your father died?

A. The Colyears had been close family friends to my mother and father.

Q. Well, Mr. Colyear took over the management of the Schalk Chemical Company. You have been sitting in the courtroom all this time, have you not, Mr. Smith, and you have heard that testimony from various sources? A. Yes.

Q. Did you have any discussions with Mr. Colyear during say 1931 relative to your taking a position with the company?

A. Not in 1931, I was still going to school.

(Testimony of Horace O. Smith, Jr.)

Q. I see. When did you first have a talk with Mr. Colyear regarding employment in Schalk Chemical Company?

A. It must have been about somewhere around 1933 or 1934; I am not exactly sure on that, however.

Q. 1933 or 1934? A. I would say 1933.

Q. Now, did you eventually gain employment with Schalk? A. Yes, I did.

Q. Mr. Colyear hire you? A. Yes, he did.

Q. And what was your position when you were first [397] hired, and what year was it, sir?

A. In March, 1936, and I was a salesman.

Q. Would you state whether or not there was any reason you were not employed in 1933 or 1934 when you first discussed the matter with Mr. Colyear?

A. Well, I was completing my high school and Mr. Colyear felt I was too young immediately thereafter, and was not disposed to hire me at that time.

Q. Did you know whether or not Mr. Colyear had other business enterprises that he was running, managing? A. Yes.

Q. What other business enterprise did he have?

A. He owned and operated the Colyear Motor Sales, and I believe he owned also the Colyear Furniture Company at that time.

Q. Do you know of Mr. Colyear's general reputation as a businessman?

Mr. Hall: Did he know it at that time, is that your question?

Mr. Gardner: Yes, at that time.

The Witness: Yes, I knew of it.

(Testimony of Horace O. Smith, Jr.)

Q. (By Mr. Gardner): What was his reputation?

A. He was considered to be, I presume, at that time considered to be a successful [398] businessman.

Q. And you were hired then in March of 1936, as a salesman, sir? A. Yes.

Q. How long did you remain a salesman with Schalk Chemical Company?

A. For several years, 1942 I was elected president, but even during that time I had done sales work in the field, that is by traveling with the other men in the various territories, and I still maintained a small territory of my own which I covered for the reason that I felt I could best appreciate the positions and the problems of the men in the field by so doing.

Q. Would you state, if you know, whether or not Mr. Colyear was grooming you to take over the position as president of Schalk Company, sir?

A. I believe he was.

Q. Now, who was the manager of Schalk in 1936 when you were first employed, that is, manager of the Los Angeles plant? A. Mr. H. C. Lieben.

Q. How old was Mr. Lieben at that time, approximately, sir, if you know? A. In 1936?

Q. Yes.

A. He is 65 now, so he couldn't have been over about 37 years.

Q. And how long had he been with the company, sir, if you know, in 1936?

(Testimony of Horace O. Smith, Jr.)

A. He had been with the company several years prior to that.

Q. Were you ever present when Mr. Lieben and Mr. Colyear discussed the business affairs of Schalk Chemical Company? A. Yes, I was.

Q. And did they have many discussions during the period from 1936 to 1942, sir?

A. I presume so. However, a good deal of the time I was out on the road so I wasn't in the office at all times.

Q. In other words, you mean they had discussions at which you were not present? A. Yes.

Q. But speaking of the discussions, were you present with Mr. Lieben and Mr. Colyear, did you have numerous discussions such as those?

A. Quite a few, I would say.

Q. What was Mr. Colyear's opinion of Mr. Lieben, if you know, sir?

Mr. Hall: I object, your Honor, on the ground it is hearsay evidence. Same problem as Mr. Gardner raised with regard to Colonel Dillon. I don't have the opportunity to test [400] the credibility of the opinion.

The Court: Sustained.

Q. (By Mr. Gardner): Did Mr. Lieben remain manager from, on up until 1942, sir, do you know?

A. Yes, he did.

Q. And he worked directly under Mr. Colyear, is that correct, sir? A. Yes.

Q. Do you know Mr. Fulmer of the Chicago office? A. Yes, very well.

(Testimony of Horace O. Smith, Jr.)

Q. When did you first meet Mr. Fulmer, sir?

A. I had met Mr. Fulmer many years ago when I was a small youngster, through my father.

Q. Now, after you became associated with the business, 1936, when did you next meet Mr. Fulmer?

A. I believe it was the spring of 1937.

Q. And what was his position at that time, if you know? A. General sales manager.

Q. General sales manager, out of the Chicago office, sir? A. Yes.

Q. Who was in charge of that plant, if you know? A. Mr. Fulmer.

Q. Mr. Fulmer was, and Mr. Fulmer worked directly [401] under Mr. Colyear also, is that correct, sir? A. That is correct.

Q. Now, how long had Mr. Fulmer been in charge of the Chicago office, that is, we are speaking now as of 1936 or 1937?

A. Oh, I would say at least ten years.

Q. In other words, he had been in charge of that office under your father, hadn't he? A. Yes.

Q. Now, we go on up to 1942. Could you state whether or not of your own knowledge Mr. Farman attempted to gain employment with Schalk Chemical Company during any of the years 1936 to 1942, sir?

Mr. Hall: I object on the ground the question is too broad, it isn't pinpointed at any specific date. If Mr. Gardner knows when this occurred, he can pinpoint it. I don't think it is fair to ask the question over a five-year span, and it should be first pin-

(Testimony of Horace O. Smith, Jr.)

pointed as to who was present, where it was, and other material data.

The Court: The question is not improper. The witness may answer.

Mr. Gardner: Would you like the question read?

The Witness: Yes.

(The record was read.)

The Witness: I believe at one time Mr. Farman attempted to get a position with the Schalk Chemical Company. [402]

Q. (By Mr. Gardner): When was this?

A. I could not tell you the definite date.

Q. Could you tell me whether or not it was before 1940? A. I believe it was.

Q. And do you know the result of his attempt to gain employment, sir?

A. He was not successful in gaining employment at that time.

Q. Whose decision was this?

A. I believe it was Mr. Colyear's. I am not positive, however.

Q. All right, sir, now going on to the time when you took over as president and supervisor, what year was that that you took over as president?

A. 1942.

Q. Was Mr. Colyear still alive then, sir?

A. Yes, he was.

Q. Was he ill at that time?

A. Not at that time, no.

Q. Not at that time. Did you have any discussions with Mr. Colyear as to whether or not you were ready to take over the presidency of this or-

(Testimony of Horace O. Smith, Jr.)

ganization? A. Yes. [403]

Q. Mr. Colyear felt that you were ready?

A. Evidently.

Q. Now, when you first took over of course I suppose you worked closely with Mr. Colyear, did you not?

A. No, not too closely with Mr. Colyear, but I did work closely with Mr. Lieben and Mr. Fulmer.

Q. Now, if you had any major decisions or anything, I suppose you would naturally take that up with Mr. Colyear, then, wouldn't you?

A. Right.

Q. What about Mr. Fulmer, did you have any discussions with Mr. Fulmer in 1942 and prior to Mr. Colyear's death? A. Yes; yes, I did.

Q. And was it your intention to leave Mr. Fulmer on as manager? A. Yes.

Q. Was that Mr. Colyear's intention?

A. I believe it was.

Q. After Mr. Colyear died, I believe that was in 1943, was it not?

A. 1943 or 1944, I am not certain.

Q. In any event, after his death did you become the supervisor under the trust? A. Yes, I did.

Q. And as supervisor under the trust, would you state [404] whether or not it was your intention to continue the business policies of Mr. Colyear in relation to the Schalk Chemical Company?

A. To a certain extent, Mr. Gardner.

Q. And in what extent did you intend to deviate?

A. In view of the situation, I was probably a

(Testimony of Horace O. Smith, Jr.)

little closer and more interested in the Schalk Chemical Company, and it was my livelihood and I was more interested in seeing it progress and grow.

Q. In other words, you were going to devote full time to this one enterprise, were you not?

A. That is correct.

Q. Now, during these years following the time when you were appointed supervisor, and on up to the time that you resigned, which was in 1948, January 15, 1948, was it? A. Yes.

Q. Up to that date, sir, did you attempt to develop new products? A. Yes, we did.

Q. Now, you have heard Mr. Farman testify that he provided you, or the Schalk Chemical Company, with numerous items to be developed and put on the market by Schalk. Would you state, sir, what was your practice when receiving a suggestion from Mr. Farman relative to a new product?

A. The general procedure was always to take a [405] suggestion of a new product that it was feasible to market by the company and submit it to the various salesmen in the field for their comments; being a small organization as we were, we were not in a position to hire a market analyst which are used widely by the large corporations today.

Q. Now, was that your practice when these suggestions that Mr.——

A. That was our general practice. Of course, many times people would suggest new products that we in the business would know instinctively why it

(Testimony of Horace O. Smith, Jr.)

would not be feasible to market such a product at that time.

Q. Now, did you discuss these products with Mr. Lieben?

A. Yes, I believe I did; I am certain of that.

Q. You would also seek his advice, wouldn't you?

A. Yes.

Q. You would seek the assistance of your salesmen in determining whether or not a product would move, wouldn't you? A. Right.

Q. Now, at the time you became supervisor in 1943 we were in the midst of a war, were we not?

A. That is right.

Q. Were you having difficulty obtaining materials? A. Yes.

Q. Were you having any trouble whatsoever moving your [406] products? A. No.

Q. In other words, I take it you could sell just about anything that you could get hold of at that time, couldn't you, sir?

A. That seemed to be apparent.

Q. Did you have a labor problem?

A. Yes, we did.

Q. What was your labor problem?

A. We were, as all other concerns, were under the regulations of the War Manpower Act, I believe that is what it was called, and being in a nonessential business we were not in a position to hire new people, new laborers, factory help and so forth, without a priority.

(Testimony of Horace O. Smith, Jr.)

Q. This created quite a labor shortage in your organization, the Schalk Company, didn't it?

A. Yes, it did.

Q. So not only were you short of materials, even had you obtained more materials you wouldn't have been able to dispense or put the product out because of the labor shortage, is that correct, sir?

A. Pretty much so, I believe.

Q. Now, would you state, sir, when the first friction arose over your actions as supervisor?

A. I really don't know, Mr. Gardner; it appeared from [407] the beginning that my family did not want me to be supervisor of the trust and thereby vote stock and be president of the corporation.

Q. Was this feeling apparent even prior to the time you became president of Schalk?

A. I believe so.

Q. Do you know whether or not of your own knowledge there was an apparent animosity by the other stockholders toward Mr. Colyear?

A. Yes, very definitely.

Q. And how long had that existed, of your own knowledge?

A. For quite some years after 1931.

Q. In fact, the entire history of the management of Schalk from the inception of the trust was one of dissension, wasn't it?

Mr. Hall: I object to that as a leading question. Stating something that is not in evidence.

Mr. Gardner: Very good objection.

(Testimony of Horace O. Smith, Jr.)

Q. (By Mr. Gardner): But in any event, when you became the supervisor in 1943, there was dissension as between you and the other members of the family, the other stockholders? A. Yes.

Q. Now, who was the spokesman for the family?

A. I think Mr. Farman was, it was generally conceded [408] he was.

Mr. Hall: I didn't hear that answer.

The Witness: I say I think Mr. Farman was, it appeared that way.

Q. (By Mr. Gardner): Now, in 1945, I believe you have been in the courtroom and you heard Mr. Farman testify; in 1945 he came to the company and was hired as an expediter? A. Yes.

Q. Had he made any earlier efforts to obtain employment with Schalk Company while you were the supervisor or president?

A. I believe he did, I think the whole thing had built up to that point where in 1945 that the Chemical Company put Mr. Farman on.

Q. In other words, he had attempted to gain employment there prior to 1945?

A. Well, for a time there, he was employed by government agencies, and was not seeking employment at that time.

Q. I see. Did you talk over the possibility of hiring Mr. Farman with Mr. Lieben?

A. Yes, I did.

Q. What was Mr. Lieben's reaction?

Mr. Hall: May I object to the question if it is going [409] to the opinion of the witness; if it is

(Testimony of Horace O. Smith, Jr.)

asking did Mr. Lieben object or did he not object, I have no objection to the question, but I don't want him to state an opinion; Mr. Lieben is not here, it would be hearsay and I don't have the opportunity to cross-examine Mr. Lieben. The question is ambiguous to that extent. If the witness could answer and not state an opinion stated by Mr. Leiben.

The Court: Will you rephrase your question, Mr. Gardner?

Q. (By Mr. Gardner): Did Mr. Lieben object to the hiring of Mr. Farman by Schalk Chemical Company? A. Yes, he did.

Q. Did you discuss the possibility of hiring Mr. Farman with anyone else, sir?

A. With Mr. Fulmer.

Q. Mr. Fulmer? A. Yes.

Q. Did Mr. Fulmer object to the hiring of Mr. Farman?

A. I don't recall exactly whether he did or not, but it was left pretty much up to my decision, I believe.

Q. And your decision was to hire him?

A. Yes.

Q. Now, at that time, 1945, you were having difficulty getting materials, that is correct, isn't it, sir? A. Yes. [410]

Q. And you needed—whose idea was it to get an expediter to obtain these raw materials?

A. I believe it was Mrs. Farman's and Mr. Farman's idea.

Q. So you hired him on that basis, is that correct? A. Yes.

(Testimony of Horace O. Smith, Jr.)

Q. That was just about the only job available in the corporation at that time, wasn't it?

A. Yes.

Q. Now then, when was the executive committee set up?

A. You have the dates, Mr. Gardner, it must have been the latter part of 1955.

The Court: 1955 or 1945?

The Witness: 1945, pardon me.

Mr. Hall: It was in September, 1945, Mr. Gardner. [411]

* * *

Q. (By Mr. Gardner): Mr. Smith, just prior to the recess we were discussing the executive committee which was formed in 1945, I believe. Now, would you state to the Court just exactly your understanding of the functions of that committee?

Mr. Hall: I object, your Honor, on the ground that it is not the best evidence. The powers and the purpose and the legal rights incident to the executive committee are set forth in the resolution setting up the executive committee, and the powers of the executive committee are those set forth in those minutes and no other.

The Court: I will receive the witness' testimony, not necessarily as evidence of what the powers of the committee were, but I will receive it as evidence of what he conceived them to be.

Mr. Gardner: Would you read the [413] question?

(The record was read.)

(Testimony of Horace O. Smith, Jr.)

The Witness: The executive committee was set up to handle management affairs of the corporation, and came about by reason of the fact that there was internal strife in the organization. We attempted to meet on a ground on which we could work harmoniously. As to the functions of the committee, I think the minutes state, the resolutions setting up that committee show the functions of that committee.

Q. (By Mr. Gardner): Might I request, Mr. Smith, that you speak a little louder?

Now, the executive committee as such was comprised of whom?

A. Mr. Farman, Mrs. Farman and myself.

Q. As supervisor you could have ruled against this, the formation of this executive committee, could you not, sir? A. Yes.

Q. Were you attempting at this time to work out a peaceable settlement? A. Yes.

Q. That was the intent of all parties, wasn't it?

A. Yes.

Q. Now, did the executive committee as such hold meetings in 1945?

A. I believe they did. [414]

Q. I show you Exhibit No. 32 which purports to be minutes of executive committee meetings. I ask you to examine that exhibit and state whether or not you have ever seen those minutes. [415]

* * *

The Witness: Frankly, I don't recall ever seeing these, this memoranda before.

(Testimony of Horace O. Smith, Jr.)

Q. (By Mr. Gardner): Can you state whether or not you ever recall in any meeting listening to Mr. Farman read the minutes of the prior meeting?

A. I do not.

The Court: Were you present at these meetings?

The Witness: Yes.

The Court: I notice that at the end of some of them and possibly at the end of all of them there is a, those in handwritten form, in any event, there appears the word "Approved" and then three lines underneath that word "Approved." Apparently space for three signatures, and two of those lines have signatures, one of them, G. I. Farman and the other H. I. Farman and the third line is blank. Were these ever submitted to you for your signature?

The Witness: Not to my knowledge.

The Court: Proceed. [416]

Q. (By Mr. Gardner): Now, Mr. Smith, let's go on to the eventual dissolution of the executive committee. Would you state just briefly what events led up to the dissolution of that committee?

A. I believe that came about because of lack of harmony in management in the executive committee. I felt that it was serving no purpose as far as the corporation was concerned.

Q. Was there an effort on the part of the other stockholders to introduce new products, sir?

A. Yes.

Q. And these are the products that you have tes-

(Testimony of Horace O. Smith, Jr.)

tified you attempted to test by sending to your salesmen? A. Some we did, yes.

Q. Some you did. Now, I believe you testified that in 1946 you were short of materials and short of labor? A. That is right.

Q. In other words, this was not, or was this an opportune time to attempt to develop new products?

A. It might have been the time to attempt to develop new products, but it was surely not the time to market new products.

Q. In fact, in 1946 you were having all you could do to supply your already existing demands, is that correct? A. That is correct. [417]

Q. Now, would you state whether or not you attempted to develop new products other than those suggested by Mr. Farman during the year 1946?

A. Frankly, I don't recall, but I doubt if we would have at that time. We had put on two new products just prior to the war, we were attempting to market those to the best of our ability.

Q. You were also attempting to get caught up with the demand? A. With the demand.

Q. From the customers that you already had?

A. That is correct.

Q. Now, then, going to the agreement of January 15, 1948, would you state when the first discussion resulting in that agreement occurred?

A. It was no doubt in the early part of 1947, May or June, I would say.

Q. When, sir? A. May or June.

Q. Of 1946 or 1947, sir?

(Testimony of Horace O. Smith, Jr.)

A. Of 1947, I believe.

Q. Of 1947. Now, was there a lawsuit brought about April of 1947? A. Yes.

Q. And you know when the first discussion relative to [418] that particular action took place as between you and the other stockholders?

A. As I recall, no one discussed it with me prior to the time I was served with the summons or papers in regard to that lawsuit.

Q. Now, when did the executive committee dissolve? A. Early in the spring of 1947.

Q. 1947 or 1946?

A. 1947, I believe, it must have been around March.

Q. Now, would you state whether or not the executive committee in your opinion ever worked smoothly?

A. I did not feel that it did; consequently, we dissolved it.

Mr. Hall: Who do you mean by we, Mr. Smith?

The Witness: The Board of Directors of Schalk Chemical Company.

Q. (By Mr. Gardner): Now, during 1946 did you have any discussions with Mr. Farman or with the other members of the family, the other stockholders, regarding either the purchase of their stock or the sale of your stock? A. Yes.

Q. In this company? A. Yes.

Q. When did this first discussion take [419] place?

A. As I recall there were numerous discussions

(Testimony of Horace O. Smith, Jr.)

along that line. I could not tell you the exact dates that those discussions took place, but there were various proposals made, various discussions, the purpose of which was to eliminate the strife and disharmony in the corporation, in the management.

Q. Did you ever suggest to the other members of the family that you purchase or acquire their stock, their beneficial interest in the stock?

A. No, I suggested to my mother that she sell the corporation at one time.

Q. This was in 1946, is that correct, sir?

A. I would seem to think that it was in 1946.

Q. At that time did you have any idea as to what the corporation might bring if sold?

A. I felt that it could be sold for close to a half million dollars.

Q. At that time?

The Court: What do you mean by selling the corporation? Are you referring to a sale of all of the stock of the corporation?

The Witness: All of the stock of the corporation, yes, sir.

Q. (By Mr. Gardner): And what did your mother say to your suggestion?

A. They were not interested in selling the corporation. [420]

Q. Did you suggest to her that she purchase your stock? A. Yes.

Q. And it was at this time that you entered into the negotiations which finally resulted in the agreement of January 15, 1948, is that correct, sir?

(Testimony of Horace O. Smith, Jr.)

A. That agreement came about after the lawsuit in the spring of 1947.

Q. I see. In other words, you had discussions even prior to the lawsuit as to the possibility of selling either your stock or acquiring hers?

A. Yes.

Q. Did you ever talk to her, that is, Mrs. G. I. Farman, about acquiring her stock?

A. I don't believe I did for the reason I was not in a position to offer what I thought it was worth.

Q. What did you think the stock was worth in 1946, sir?

A. Well, as I stated before, I felt that the corporation could be sold for somewhere around a half million dollars. At that time businesses were being sold on as much as thirteen times the net profit, and our record of profits the past years indicated a good earning power of the corporation.

Q. The name Schalk was well known throughout the United States at that time, too, wasn't it?

A. Yes, it was.

Q. Would you say it had a valuable [421] goodwill?

A. Very much so, even though we showed the goodwill and formulas as only $1.00 on our balance sheet.

Q. You didn't set any price other than $1.00 on your balance sheet? A. That is right.

Q. But you did give consideration to that in determining the value of the corporation and the value of the stock? A. Very definitely.

(Testimony of Horace O. Smith, Jr.)

Q. Now, after the lawsuit in April of 1947, did you have any discussions with the other members of the family, the other stockholders, regarding the sale of your beneficial interest of the stock of the Schalk Chemical Company? A. Yes, I did.

Q. When did the first discussion take place after the trial?

A. I don't recall the exact date, Mr. Gardner.

Q. Well, do you recall who was present?

A. I discussed the possibility of an agreement such as the one we entered into many times with Mr. Stanley W. Guthrie, together with Mrs. Farman and I believe Mr. Farman and my two sisters.

Q. Who was going to purchase your beneficial interest in the stock of the Schalk Chemical Company? A. My mother and two sisters. [422]

Q. Was there any mention made of the corporation purchasing your beneficial interest in the stock of the Schalk Chemical Company?

A. Not as I recall.

Q. Was it your understanding that you were dealing with them on an individual basis?

A. Yes. You see, I was not in a position to sell my stock interest or my beneficial interest in the trust, therefore, I was compelled to deal with the two other beneficial holders of the trust.

Q. And it was your understanding that you were dealing with them in their individual capacity, is that correct? A. Yes.

Q. I believe you have already stated this, but would you state once again for the record, whether

(Testimony of Horace O. Smith, Jr.)

or not you had any discussions with Mr. Farman, Mrs. Farman, your two sisters, regarding the corporation purchasing your beneficial interest in the stock of Schalk Chemical Company?

A. Of the corporation purchasing it?

Q. Yes.

A. I honestly don't recall, Mr. Gardner.

Q. Was it your impression that at all times you were dealing with them as individuals?

A. That is right.

Q. Now, how did you receive the amount, I believe it [423] was, it has been testified to that it was $25,000.00 that was paid you on January 15, 1948? A. Yes, sir.

Q. How did you receive that money, sir?

A. In the form of a certified check, I believe.

Q. And who gave it to you?

A. Mr. Guthrie.

Q. Mr. Guthrie. Now, you understood this to be payment of certain moneys from whom?

A. From my mother, Mrs. Farman, and my two sisters.

Q. And how much were you to get from your mother?

A. It wasn't stipulated what her share of that was to be, as I recall.

Q. In other words, you were selling your beneficial interest in that stock? A. In the trust.

Q. In the Schalk Chemical Company, to your mother and two sisters? A. Yes.

(Testimony of Horace O. Smith, Jr.)

Q. Now, in 1950 was there an additional amount due you? A. Yes.

Q. What was that amount, sir?

A. $20,000.00.

Q. $20,000.00; now, who did you look to for payment [424] of that $20,000.00?

A. The same parties that paid me the $25,000.00.

Q. Who was that, sir?

A. Mrs. Farman, my mother, and two sisters.

Q. Now, at the time that you made this original agreement, that is, back in January, January 15 of 1948, just exactly what were you selling for the $45,000.00?

A. My beneficial interest or stock interest in the Schalk Chemical Company.

Q. Did you feel that the stock, that is, the shares of stock had a value of $45,000.00, sir?

A. Yes.

Q. Now, you were also giving up a position, weren't you? A. Yes.

Q. How much was that position paying you at that time, sir?

A. $6000.00 a year, I believe.

Q. Was it your understanding that you were to receive any amount for the loss of the $6000.00 that you would subsequently incur?

Mr. Hall: Pardon me, I didn't get the question.

Mr. Gardner: Let me rephrase it, anyway.

Q. (By Mr. Gardner): Was it your understanding that any portion of the [425] $45,000.00 that you were to receive under the agreement of

(Testimony of Horace O. Smith, Jr.)

January 15, 1948, was to reimburse you for the loss of your position and $6000.00 a year for the next three years? A. No, it was not.

Q. Did you feel that you could get another job just about as good as the one you were leaving, sir?

A. No, I was rather doubtful about that.

Q. Did you feel that you could get a job paying substantially the same, sir? A. Yes. [426]

* * *

Mr. Hall: Your Honor, may I request the privilege of calling Mr. Olson at this time, because Mr. Olson is engaged in commitments later today, and I would like to present his direct examination at this time.

Mr. Gardner: No objection, your Honor.

The Court: You may do so.

Mr. Hall: Mr. Olson.

MILO V. OLSON

a witness called by and in behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: Would you state your name and address for the record?

The Witness: Milo V. Olson. 1409 Hillcrest Avenue, Pasadena.

The Clerk: o-n, or e-n?

The Witness: o-n.

(Testimony of Milo V. Olson.)

Direct Examination

By Mr. Hall:

Q. Mr. Olson, are you an attorney at law?

A. Yes, sir.

Q. In 1947 and 1948, were you a partner of the law firm of Guthrie, Darling and Shattuck?

A. I became a partner, I think it was November 1, 1947. I worked there as an employee from January 1, '47, until November 1, '47. [430]

Q. Are you acquainted with the action filed in 1947 in the Superior Court of the State of California, for the County of Los Angeles entitled Evelyn Smith Marlow and Patricia Farman Smith—or, excuse me—Patricia Farman Baker, versus Union Bank and Trust Company, Horace O. Smith, Jr., and other parties?

A. I am familiar with that action.

Q. Did you participate with Mr. Stanley W. Guthrie in the preparation of the complaint filed in that action?

A. Yes, with Mr. Guthrie and with other members of the firm.

Q. Did you handle the demurrers which were filed to that complaint?

A. I argued the demurrer.

Q. May I have Petitioner's Exhibit 16?

Mr. Olson, I hand you Petitioner's Exhibit No. 16, and I ask you if you are familiar with that document?

(Testimony of Milo V. Olson.)

A. You have to pardon me. What I thought was a copy of it appears to be a copy, but it is not a ribbon copy. So, I will have to check.

What I have in mind is this copy, obviously not made at the same time. This is an exact copy of what I have here, in my file, and I am certainly familiar with this Exhibit No. 16.

Q. Did you participate in the negotiations leading [431] to that agreement? A. Yes, I did.

Q. Who did you deal with in those negotiations?

A. Well, in my own firm, I dealt, of course, with Mr. Guthrie, and on the other side, why, it was Mr. Wackerbarth, the attorney for Mr. Smith.

Q. Do you know Mr. Smith? A. Oh, yes.

Q. Did you deal with Mr. Smith?

A. Well, we had litigation going on; we dealt to this extent that Mr. Smith was the opposing party and his attorney was Mr. Wackerbarth, as I recall. To that extent, we dealt with Mr. Smith, but only through Mr. Wackerbarth. I think Mr. Smith was present at certain of our conferences certainly.

Q. May I have Petitioner's Exhibit 15? It is a letter.

Mr. Olson, I hand you Petitioner's Exhibit 15; do you recall that document?

A. I notice this document is dated September 20, 1945.

Q. I am sorry.

A. And I undoubtedly have seen it, but that is

(Testimony of Milo V. Olson.)

not one of the documents I reviewed last evening in getting ready for my testimony today. [432]

Q. I made a mistake. I had the wrong exhibit number. It is a letter dated——

A. To answer your question, I am undoubtedly familiar with it, but I haven't reviewed it recently.

Q. A letter dated September, '47.

A. September 12, '47. Is that the letter you have reference to?

Mr. Hall: Excuse me, Exhibit No. 22, your Honor.

Q. (By Mr. Hall): Mr. Olson, I hand you Petitioner's Exhibit No. 22, do you recall that letter?

A. Yes. I reviewed a copy of this letter which I have in my file here, my old file. So I do recall that document, Exhibit 22.

Q. That bears what date?

A. September 12, 1947.

Q. Prior to that date, did you submit any settlement proposals to Mr. Smith or Mr. Wackerbarth?

A. I have here the answer to your question is yes.

Q. What proposal did you submit?

A. I submitted—I have to take it out, 69 file, a copy. I don't believe an original, but a copy of the memorandum which was prepared in somewhat rough draft for me, which I have here.

I think this was undoubtedly handed either by me [433] or Mr. Guthrie to Mr. Wackerbarth prior

(Testimony of Milo V. Olson.)

to September 12, 1947. This document I have right here.

Q. Have you reviewed that document?

A. Yes. I looked it over last night.

Q. What is the proposal contained in that document?

A. Well, the proposal contained in the document, basically, was that Schalk Chemical Company would procure, or be successful in procuring the resignation of Mr. Smith, as a supervisor, and pay him the sum of $25,000, and it was suggested that that be paid over the period of five years, and that Mr. Smith would render some consulting services during the five years, as consideration, apparent consideration for the $25,000.

Frankly, the $25,000 was being paid to Mr. Smith and was suggested to be paid to him so he would resign as supervisor or manager of the Schalk Chemical Company, and the other part of the proposal which is here in writing, speaks for itself, but the other part of it was that there would be an option given to Schalk Chemical Company to buy Mr. Smith's stock, and I have in mind, as I recall at that time, there was a problem because I believe his stock was in trust in some way. I would have to review that.

But my recollection was that there would be an option to buy his stock for additional sum of $20,000.

I believe that is what this thing says. [434]

(Testimony of Milo V. Olson.)

Q. And that proposal was submitted to whom, Mr. Olson?

A. It was submitted to, undoubtedly, and I say undoubtedly because that is the way we handle it, to Mr. Wackerbarth on behalf of Mr. Smith. It was submitted by Mr. Guthrie and me on behalf of our clients.

We were purporting to represent the Farman family group to get the Schalk Chemical Company in control, you might say, of Mr. Farman, and to eliminate Mr. Smith as supervisor, and this was the proposal that was submitted in that regard.

Q. Was there any proposal to pay him the $25,000 in a lump sum?

A. I think that was also considered.

Q. That was to be paid by whom?

A. That was to be paid by, as I recall now, that was to be paid by Schalk Chemical Company, and we were going to work it out by having the individuals make a loan to the Schalk Chemical Company so it would have the loan to pay Mr. Smith $25,000. My notes indicate that.

The Clerk: Petitioner's Exhibit 37 for identification.

(The document above referred to was marked Petitioner's Exhibit No. 37 for identification.) [435]

Q. (By Mr. Hall): Mr. Olson, I hand you a document marked Petitioner's Exhibit 37 for identification. Is that the memorandum to which you referred?

(Testimony of Milo V. Olson.)

A. That is the memorandum which I referred to, as the proposal that was submitted to Mr. Wackerbarth as attorney for Mr. Smith.

I don't say—that document was a copy of that document, obviously, Mr. Hall.

Mr. Hall: I offer this document as Petitioner's Exhibit 37.

Mr. Gardner: May I ask a few questions on voir dire, your Honor?

Voir Dire Examination

By Mr. Gardner:

Q. I note that this document bears no date, sir. Could you tell me what date this document was prepared?

A. The fact that it was before, undoubtedly before we received back the letter dated September 12, 1947, I couldn't tell you whether it was in September or whether it was in August, but it was during the year 1947, because I didn't, I didn't start working on this matter till after January 1.

Pardon me. I wrote one memoranda in my old office in 1946, but I didn't start working actively on this matter until after the lawsuit was filed, with regard to any [436] settlement. The lawsuit——

Q. Till after the lawsuit?

A. Till after the lawsuit was filed.

Q. I see.

A. So, it would be between the time the lawsuit was filed and September 12, 1947.

(Testimony of Milo V. Olson.)

Q. That would be between April 28 of 1947?

A. If that is the date the complaint was filed, yes.

Q. Well, I am not too positive about that. It was in April, April 14 or 28, I believe, sometime between that date and September.

A. My guess would be it would be later than that. It would probably be after the demurrer had been sustained, to the original complaint. That is when we really got down to negotiating on this matter, other phase of the matter, rather than litigating any further.

Q. I notice, sir, this is in rather rough form.

A. That is what I testified.

Q. Yes, of course. Did you present a copy of this to Mr. Wackerbarth for his keeping?

A. Yes. That I never want to say positive, because every time I do, I am quite sure undoubtedly that is the case, because that was the purpose of preparing the memorandum.

Q. Did the copy that you gave to Mr. Wackerbarth contain these same deletions? [437]

A. That I don't doubt. I don't know. That might have occurred during a conference with Mr. Wackerbarth. I don't know.

Q. In any event, this was a preliminary step, as I take it, in your negotiations?

A. This was our proposal, one proposal. I had other proposals in mind that I suggested to Mr. Guthrie. This was the proposal we finally submitted to Mr. Wackerbarth.

(Testimony of Milo V. Olson.)

Q. I see.

A. I don't say finally. It is the one we submitted to him.

Q. It is one of the proposals?

A. That is right.

Q. That is, that you submitted to him?

A. That is right.

Mr. Gardner: I have no objection to this document.

The Court: Admitted.

(The document heretofore marked for identification Petitioner's Exhibit No. 37 was received in evidence.)

The Clerk: Exhibit 37.

The Court: Did you say that the demurrers were sustained?

The Witness: With leave to amend, so that is while we are waiting to prepare the amended complaint, that the [438] negotiations got underway. As I recall, we got extensions of time on that leave.

Direct Examination
(Continued)

By Mr. Hall:

Q. Were any other settlement proposals made to Mr. Smith, or Mr. Wackerbarth?

A. Well, I don't know how to answer that. I do know we got a counter proposal from Mr. Wackerbarth on behalf of Mr. Smith, and which is your Exhibit 22 here in evidence.

(Testimony of Milo V. Olson.)

And then there were further negotiations that ensued and the result was this agreement which you showed me, Exhibit 16.

Q. Well, Mr. Olson, did Mr. Smith and Mr. Wackerbarth refuse all proposals that the corporation pay Mr. Smith and take an option on his stock? A. Yes.

Q. Was it the intent and desire of the family at all times that the settlement be effected between the corporation and Mr. Smith? A. That was.

Mr. Gardner: If the Court please——

The Witness: I assume he is objecting, so I will wait.

Mr. Gardner: May I object to, as to this witness testifying as to the intent of the family. He can state what the family told him, but I think that that would be [439] assuming something. It is a conclusion.

The Court: Sustained.

Q. (By Mr. Hall): Were the settlement proposals discussed with the family?

A. Many times.

Q. What member of the family were they discussed with, usually?

A. Well, usually with Mr. Farman, Mrs. Farman and I know I went out to their home in Sierra Madre and the whole family were there. I mean, the daughters and the sons-in-law were there.

Q. What did they state to you with regard to the manner in which they wished the settlement to be effected?

(Testimony of Milo V. Olson.)

A. I cannot give you exact conversation at this time. I can give you the substance of what our conversations were.

Q. Please do.

A. In substance, my instructions were to attempt to figure out a way where the Schalk Chemical Company could pay Mr. Smith in the manner in which was set forth in that exhibit, which just went into evidence—whatever number you put on that. That was the basic idea of—I call it my clients, or really Mr. Guthrie's clients.

And I mean it is expressed as well in there as I [440] could state it.

Q. You put in considerable study on this matter?

A. Yes, indeed I did.

Q. In your opinion, did the family, as opposed to Mr. Smith, have any choice as to the manner of making the settlement?

A. If you state settlement, Mr. Smith would only settle on the basis which was set forth in the agreement that was finally executed as was contained in the memoranda or letter of September 12, 1947.

As I understand, the settlement, your choice is what the other party is willing, finally willing to do. I don't know how to answer. The family could have continued to litigate. They did have that choice, but we choose to settle.

Mr. Hall: You may examine.

(Testimony of Milo V. Olson.)

Cross-Examination

By Mr. Gardner:

Q. Mr. Olson, I believe you testified that you represented the members of the family, the stockholders, other than Horace Smith?

A. Oh, I don't know how to answer. We represented the Plaintiff in the case, but we were basically representing Mr. and Mrs. Farman, and those members of the family that were sympathetic to the—Mrs. and Mr. Farman, if that answers your question, that those are the people we were [441] representing.

Q. Did they seek your advice in representing them? A. Often.

Q. And did you make a study of the best way, that is the most advantageous way to them, personally, and to the corporation?

A. My study——

Q. To—— A. Pardon me, excuse me.

Q. To obtain the stock of Horace Smith, Jr., as well as control of the corporation in 1947?

A. The answer is yes.

Q. And did you advise them of the results of your study, sir?

A. I will answer you this way: I gave the memoranda giving my opinions to Mr. Guthrie and then Mr. Guthrie in my presence would advise them, so it was actually Mr. Guthrie who was speaking, and I was sitting there, participating to this point where I would answer, yes, sir.

(Testimony of Milo V. Olson.)

Q. And this proposal that we have here, that was the result of your advice to the stockholders; wasn't it?

A. You are speaking now of which exhibit, please?

Q. The proposal Exhibit No. 37, sir.

A. Yes. That is a result of one part of my advice. I have another memoranda here, if you are interested in where [442] I had another idea on the matter.

Q. The point is that you advised them that this was the thing to do?

A. Yes, or we wouldn't have submitted it.

Q. Now, did you, sir, continue to represent Mrs. Farman and the two daughters after the agreement of January, was it 15, 1948?

A. I think I have handled the final negotiations where we received court orders to put the settlement into effect. I attended the stockholders meeting, I think, where Mr. Farman was elected president.

I handled the negotiations on getting the stock certificates that were issued, and after that phase of it was completed for all practical purposes, that is the end of my participation.

Q. I see. A. In the matter.

Q. Now, I believe you, as you state in this document, the intent is to have the—that it is your intent in that document, was to have the Schalk Chemical Comany take over this obligation; is that correct, sir? A. That is right.

(Testimony of Milo V. Olson.)

Q. Could you tell me why, sir, that you did not take steps to have the corporation assume that obligation immediately on January 15, 1948? [443]

A. For the reason that I no longer handled the corporate—I am supposed to be the trial attorney in that office, and I got out of the corporate end of it as quickly as I could, so I had nothing to do with what the Schalk Chemical Company did legalwise, or any other way after this settlement agreement was executed. I got out of the picture and gave no further advice.

Mr. Darling and Mr. Guthrie were the gentlemen who handled the corporate phases of our office.

Q. So you don't know why the corporation did not take steps to assume that obligation at that time, do you? A. I do not know.

* * *

Mr. Gardner: Mr. Smith, please.

HORACE O. SMITH, JR.

resumed the stand, having been previously duly sworn, was examined and testified further as follows:

The Court: Proceed.

Cross-Examination

By Mr. Hall:

Q. Mr. Smith, I believe you testified that you were employed in 1936 by Schalk Chemical Company as a salesman; is that correct?

A. That is correct.

(Testimony of Horace O. Smith, Jr.)

Q. How long did you remain in the position of salesman with Schalk Chemical Company?

A. Even after the time that I was made president in 1942, I still had a small territory in which I serviced, and——

Q. Up to the time of your—that you were elected president, did you devote all your time to being a salesman?

A. A good percentage of the time, yes.

Q. Now, when were you elected a director of Schalk Chemical Company?

A. That I don't recall, the date. The minutes will show that.

Q. Yes. And you were also subsequently elected a vice president; is that correct?

A. That is correct.

Q. And during the time that you held those offices, up until 1942, you devoted most of your time to selling activities; is that correct?

A. Yes. I would say that was correct for the simple reason our organization was built around, it is a sales organization primarily. [445]

Q. Now, prior to working for Schalk, did you have any business experience? A. No.

Q. Now, how old was Mr. Colyear in 1942, Mr. Smith, do you know?

A. No, I don't know. He was——

Q. What would you estimate?

A. He must have been in his early 60's.

Q. Was he related to your family in any way?

A. No.

(Testimony of Horace O. Smith, Jr.)

Q. Was Mr. McGinnes related to your family in any way? A. No.

Q. Now, I believe you testified that there was animosity between the family and Mr. Colyear; is that correct? A. I believe there was, yes.

Q. And that was prior to what year?

A. It must have developed after he took over as president and supervisor of the trust.

Q. Do you know what the basis for the animosity was? A. Frankly, I don't know exactly.

Q. Did it have to do with the management of Schalk? A. Yes. [446]

Q. Was your mother opposed to Mr. Colyear?

A. Not at first, but she was later.

Q. Well, by later, do you mean a year later?

A. It must have been a year later. I am not sure.

Q. In other words, the animosity as far as you know developed in 1931? A. It could have.

Q. Were there objections by any member of the family to the manner in which Mr. Colyear was managing the corporation?

A. At what time, Mr. Hall?

Q. Well, during the time that he was supervisor and trustee? A. Yes.

Q. And was that the commencement of his taking over? A. That I don't recall, frankly.

Q. What objections do you recall?

A. That is rather difficult to answer, Mr. Hall.

Q. You have no recollection?

A. Well, there were a number of objections. I

(Testimony of Horace O. Smith, Jr.)
think the main objection was that he held close control of the corporation.

Q. Did he permit the family any say in the business at all?

A. I don't believe he did. [447]

Q. Now, Mr. Smith, you took over as president in 1942. I believe you testified that when you took over you continued Mr. Colyear's policies; is that correct? A. That is pretty correct, yes.

Q. I think you qualified that and said with some deviation? A. Yes.

Q. Yes. Well, what deviations did you have in mind?

A. I think perhaps I was a little more interested in developing new products.

Q. You were closer to the company?

A. Closer to the company, I believe, than Mr. Colyear was for that reason.

Q. Well now, Mr. Smith, don't you think the family expected you to do something different than follow Mr. Colyear's policies?

A. Yes, I believe they did.

Q. But you continued his policies except that you were closer to the picture; is that correct?

A. That is correct.

Q. Now, I believe you testified that evidently Mr. Colyear was grooming you to be president; is that your testimony? A. Yes.

Q. Well, you were named as supervisor in the trust, [448] were you not? A. Yes.

(Testimony of Horace O. Smith, Jr.)

Q. And when you succeeded to the office of supervisor, you had full control?

A. That is correct.

Q. Was it necessary for anybody to groom you for the office that was your right, was it not?

A. Under the trust indenture that was my right, providing I was willing and able.

Q. Does it provide in the trust, in the declaration of the trust, that you can resign as supervisor of the trust? A. I believe it does.

Q. Now, you testified that when you took over major decisions were discussed with Mr. Colyear. Now, you took over in 1942, Mr. Smith, at the time you took over, was Mr. Colyear in good health?

A. Fair health for a man of his age, I believe.

Q. He died short time later, did he not?

A. I think it was in '43 or '44. I am not sure.

Q. Do you know what he died of?

A. No. I believe it was a heart condition.

Q. Could it have been cancer?

A. That I don't know.

Q. Well now, you took over in September, 1942 as [449] president, as I recall.

A. Yes. But not as supervisor.

Q. Not as supervisor. What major decisions did you make in 1942 after you took over, that you discussed with Mr. Colyear?

A. Gee, I really cannot tell you that, because I don't recall.

Q. Do you have a recollection that there were any?

(Testimony of Horace O. Smith, Jr.)

A. There must have been some, and several.

Q. In what regard?

A. In general management of the business.

Q. Well, do you have any illustration of what you mean by general management of the business?

A. That was several years ago, Mr. Hall, and it would be rather difficult to testify.

Q. I appreciate that, Mr. Smith.

Where would you discuss these matters with Mr. Colyear?

A. Either at Mr. Colyear's office, or in Mr. Wackerbarth's office.

Q. Now, Mr. Smith, do you know of your own personal knowledge that Mr. Farman asked Mr. Colyear for a job at any time; that is, of your own personal knowledge?

A. No, I don't believe I can say that, as I was not [450] a witness to anything of that nature.

Q. I believe you testified yesterday that you thought that had occurred?

A. I was informed of that. Now, that is only hearsay.

Q. But you have no personal knowledge of that?

A. No.

Q. Do you have—strike that.

Now, from your observation, who did Mr. Colyear rely on to manage Schalk Chemical Company?

A. Prior to what time?

Q. Prior to the time you became president, Mr. Smith? A. Mr. Lieben.

(Testimony of Horace O. Smith, Jr.)

Q. That was from 1930 to 1942. I will reframe that question, it is not a fair question.

From the time that Mr.—after Mr. Williams left —I am not sure when that was—but after Mr. Williams left, up to the time in 1942, did Mr. Colyear rely principally on Mr. Lieben to manage the business? A. Yes, yes.

Q. And subsequent to 1942, you also relied on Mr. Lieben, is that correct?

A. That is correct.

Q. Now, was Lieben actually general manager of Schalk Chemical Company prior to 1944? [451]

A. He acted as general manager; whether or not the board appointed him as general manager, I do not recall.

Q. Yes. Well, the minutes show that he was appointed general manager in 1944. You testified somewhat at length yesterday about Mr. Lieben and his management of the company.

Did you mean that Mr. Lieben was manager of the Los Angeles office?

A. Manager of the Los Angeles office, and since the Los Angeles office was the home office, where the general books, ledgers were kept, he was also in charge of those.

Q. But Mr. Fulmer was directly responsible to Mr. Colyear; is that correct?

A. And Mr. Lieben, I believe, to some extent, he was.

Q. You testified yesterday that Mr. Fulmer was directly responsible to Mr. Colyear?

(Testimony of Horace O. Smith, Jr.)

A. I think he was; I think he was.

Q. In other words, the eastern division of Schalk and the western division was managed separately, were they not?

A. As far as sales were concerned only.

Q. Well, most of the manufacturing was, or formulation and production was done in Chicago, was it not? [452]

A. Two-thirds, yes, approximately.

Q. Two-thirds? A. Yes.

Q. Now, you relied on Mr. Lieben to advise you to a great extent, after you took over; is that correct? A. That is correct.

Q. Now, were you and Mr. Lieben always in accord on whether proposals for products were good or bad? A. No.

Q. Now, did Mr. Fulmer object to Mr. Lieben's appointment as general manager in 1944?

A. I do not know whether he was or not.

Q. Do you know if Mr. Lieben ever went to the Chicago office of Schalk Chemical?

A. Many times.

Q. And when was that?

A. I couldn't tell you the dates, Mr. Hall, but he was back there at least once a year.

Q. Was that up to the time that you took over?

A. No, prior to that, and also after the time I took over.

Q. Well, after the time that you assumed control, do you recall the occasion when he was back there in Chicago?

(Testimony of Horace O. Smith, Jr.)

A. He would be back there when we would have our annual sales meetings. [453]

Q. And were you there at the same time?

A. Yes.

Q. And was there any antagonism between Mr. Fulmer and Mr. Lieben at that time?

A. Not to my knowledge.

Q. When did you first become acquainted with Gerald I. Farman?

A. It must have been in 1928. I am not sure on the date, however, may have been prior to that.

Q. Do you recall when your sisters first designated Mr. Farman to be a director of Schalk?

A. No, I do not.

Q. Well, the minutes reflect, Mr. Smith, that it was in 1944. Was there some controversy going on at that time between the family and you?

A. Yes, there was.

Q. Now, as part of one attempt to overcome that dispute, was Mr. Farman elected a director?

A. Ultimately he was. I don't know the exact date that that took place. The minutes will show.

Q. Was it in connection with the attempt to settle the dispute that he was elected a director?

A. I believe it was, yes.

Q. Who did he replace as a director, Mr. Smith?

A. I don't recall, frankly. [454]

Q. Did he replace Mr. Lieben?

A. It is a possibility. I would have to look over the minutes to find out.

(Testimony of Horace O. Smith, Jr.)

Q. Yes. Was Mr. Farman also elected an officer of Schalk? A. Yes.

Q. And what office did he hold?

A. I think he was elected as vice president.

Q. And he held that office in 1946; is that correct? A. I believe so.

Q. What functions did Mr. Farman perform in the management of Schalk in 1945 and '46?

A. I believe the principal function was to expedite materials, raw materials and so forth.

Q. In other words, to procure?

A. Procure raw materials.

Q. Raw materials and supplies, that were short at that time? A. Yes.

Q. You say the prime function; were there other functions?

A. Oh, there must have been other functions that he performed, yes.

Q. Well, did he do anything with regard to modernizing equipment? [455]

A. I believe it is my recollection that he ordered a piece of fully automatic equipment for the Chicago plant.

Q. Did he participate in the purchase of some semi-automatic equipment?

A. He might have.

Q. Did Mr. Farman have anything to do with changing the style of packaging of Schalk products, in that year? A. Yes.

Q. What was done with regard to packaging of Schalk products in that year?

(Testimony of Horace O. Smith, Jr.)

A. I am not sure whether it was in 1946 or not, but we were all aware of the fact that modernization of the packages were desirable, and they were discussed in general sales meetings.

Q. Could you describe briefly what was done with regard to changing the packaging? Was it to make the color uniform or something along that line?

A. That was one of the objects to keep a common identity for all the Schalk products.

Q. Was that Mr. Farman's suggestion?

A. It may have been.

Q. Now, Mr. Lieben, I believe you said was antagonistic to Mr. Farman; is that correct?

A. I don't recall whether or not I worded it that way.

Q. Well, he objected to Mr. Farman coming with the [456] company, Mr. Lieben objected?

A. I believe he did.

Q. Did Mr. Lieben also object to your mother's participation in the business?

A. Not as I recall.

Q. Were there any discussions between your mother and Mr. Lieben about the management of the business? A. Undoubtedly there were.

Q. And were you present, Mr. Smith, on some of the occasions? A. Some of the occasions.

Q. And were those discussions friendly discussions between your mother and Mr. Lieben?

A. To my recollection they were.

(Testimony of Horace O. Smith, Jr.)

Q. Was your mother at any time opposed to Mr. Lieben?

A. I think she was opposed to Mr. Lieben from the very beginning.

Q. I see. Now, Mr. Lieben was displaced as a director when the executive committee was implemented; is that correct?

A. I am not sure. I would have to refresh my memory by looking at the minutes.

Q. Yes. Well, assume it to be true. Thereafter, did Mr. Lieben remain general manager of Schalk?

A. Yes. [457]

Q. Now, the executive committee was set up in September, 1945, so from that date until what date was Mr. Lieben a general manager of Schalk?

A. I could not tell you the exact date.

Q. Well, was he general manager up until the time that you resigned as supervisor and president of Schalk? A. As I recall he was.

Q. And this, Mr. Smith, was notwithstanding the objections of Mr. and Mrs. Farman to his being general manager; is that correct?

A. That is correct.

Q. Now, with regard to products, during the years 1942 to 1946, what product development program did you have; by you, I mean did Schalk Chemical Company have under your control?

A. We were always seeking new products that were, would fit into the Schalk line and could be marketed by the Schalk Chemical Company.

(Testimony of Horace O. Smith, Jr.)

Q. Well, did you have any products that were being developed in those years?

A. What were the years now?

Q. 1942 to 1946.

A. '46. Well, we put, I believe, two products out during that period.

Q. Well, are you referring to plaster pencil? [458] A. That is one, yes.

Q. Yes. Now, prior to 1946, was plaster pencil something that you were developing, Mr. Smith?

A. No, it was not.

Q. Who suggested plaster pencil?

A. I think Mr. Farman did.

Q. And the other one was spot remover, I believe; is that correct? A. Correct.

Q. That was put out by Schalk, I believe, in 1947? A. Yes.

Q. Prior to 1946, was that being developed by you or your management?

A. It had been discussed in various sales meetings prior to that time.

Q. By sales meetings prior to that time, do you mean a meeting at the Biltmore Hotel in November and December, 1945?

A. No. It had been discussed by meetings several years prior to that.

Q. Yes. What was done following those meetings with regard to that product?

A. Nothing was done to the product for one reason, was that the war was going at that time, and it was a little difficult to obtain new cans under

(Testimony of Horace O. Smith, Jr.)

Government allocation, [459] which would have been required for spot remover, and raw materials as well.

Q. I believe you testified yesterday that during the war period and including 1946, it was opportune to consider a development program?

A. That is correct.

Q. But you had none? A. That is correct.

Q. And as I understand it, you were stisfied to promote the two products which I believe you say were added prior to the war, just prior to the war?

A. I did not say that I was satisfied. I said we were forced to be, we were forced to be content with the situation because lack of raw material.

Q. And those two products were crack filler, which Schalk put on the market in 1937, and wood putty which Schalk put on the market in 1940; is that correct? A. That is correct.

The Court: Mr. Smith, I have before me the various minutes of the executive committee that were introduced as Exhibit 32, and the last sheet purports to refer to a meeting of the executive committee on July 31, 1946. The last paragraph of those, of that sheet states that Mr. Smith expressed his disfavor to adding a cement waterproof paint to the Schalk line, and voted against any further products [460] being added to the Schalk line until we complete the marketing of a paint and varnish remover, liquid Savabrush, spot remover, and P-Tile Cement.

Now, that suggests to me that they were then

(Testimony of Horace O. Smith, Jr.)

under consideration, the introduction of four new products, namely, paint and varnish remover, liquid Savabrush, and spot remover, and a tile cement.

Was there then in progress the development of those four new products, in July of 1946?

The Witness: There could have been. When you say progress, your Honor, the preparation of preparing labels and cans and formulations——

The Court: And on April 2, 1946, there appears to be minutes of a meeting which states that G. I. Farman presented a plan of purchase and—I am summarizing—a secret formula for a paint and varnish remover, a plan said to have been negotiated by Mr. Farman, and then at the end of these minutes, it is recorded that it was unanimously voted to purchase the formulas suggested.

Since you were a member of the executive committee, I take it you voted for the purchase of that formula?

The Witness: I don't recall it, your Honor; I could have.

The Court: Well, what I am trying to find out is [461] whether you, in fact, were not cooperating, that is, whether you were in fact cooperating in the development of these new products that did ultimately emerge?

The Witness: I have.

The Court: This would suggest to me that you were cooperating and if you were not, I would like to have your comments.

The Witness: I, as I testified earlier, your

(Testimony of Horace O. Smith, Jr.)

Honor, the whole purpose of the organization was to develop more products. We realized at that time, or at the time I became president, that the survival of our business was growth and it was necessary to develop more products.

Now, I have records that show that way back before the war the company was anticipating and attempting to develop a paint and varnish remover. These records are in the form of minutes of sales meetings, general sales meetings in Chicago.

The war came along and precluded that we get into that type of business at that time, simply because we could not get the necessary materials.

Mr. Hall: May I ask some questions about that, your Honor?

Q. (By Mr. Hall): Well, Mr. Smith, isn't it true that either towards the end of 1945 or in 1946, you agreed that Schalk [462] would put out a paint and varnish remover; did you agree to that?

A. I don't recall as I say.

Q. Were you in favor of it at some time?

A. Yes.

Q. Yes. Did you later say no, we are not going to put it out?

A. I don't recall, Mr. Hall.

Q. Is it possible that you said that?

A. It could have been possible.

Q. Now, liquid Savabrush, who suggested liquid Savabrush, do you recall? A. I don't know.

Q. Could it have been Mrs. Farman?

A. It could have been.

(Testimony of Horace O. Smith, Jr.)

Q. Yes. Did you agree at one time that that product should be marketed by Schalk?

A. I don't recall.

Q. Well, in 1946, Mr. Smith, did Schalk have any liquid products? A. None at all.

Q. Were you concerned with the problems of putting out liquid products?

A. I don't believe that I considered it as a major obstacle. [463]

Q. Well, did you agree at one time to put out liquid Savabrush?

A. That I don't remember.

Q. Could you have agreed?

A. I could have, yes.

Q. Yes. And thereafter, could you have refused to put it out in the years '46 and '47?

A. I don't recall. I could have.

Q. Now, Peter Putter Tile Cement. I believe that is Peter Putter. A. Plaster pencil.

Q. Or plaster pencil.

A. Peter Putter's Tile Cement, yes.

Q. Peter Putter's Tile Cement that was eventually put on the market by Schalk Chemical Company, I believe; is that correct?

A. That is correct.

Q. And that was in 1948, after you resigned?

A. I don't know; I don't recall.

Q. But it was after you resigned; is that correct?

A. I believe that we had a tile cement before I resigned.

Q. Well, what tile cement was that, Mr. Smith?

(Testimony of Horace O. Smith, Jr.)

A. That was a dry type of material.

Q. Did you have a formula for that? [464]

A. What do you mean by a formula?

Q. Well, had you acquired a formula for that product?

A. No. At the time we were buying the ingredients ready mix from another concern, mix from another concern, I believe.

Q. Was the product put on the market by Schalk that was tile cement prior to 1948?

A. I am not sure, but I believe there was. I am not positive.

Q. Well, if I show you the price list in 1947, can you tell me? A. Yes.

Mr. Hall: It is not the red one, it is the white one.

Q. (By Mr. Hall): Now, I show you, Mr. Smith, or I will hand to you, Mr. Smith, Petitioner's Exhibit 13, which is a price list dated November 1, 1947. Is there a tile cement on that?

A. No, there is not.

Q. Depicted on that list, there is not?

A. No.

Q. Would you assume from that, because of the date it bears, that there was no tile cement?

A. I would assume from that, yes.

Q. Yes. Now, is the tile cement product that Schalk eventually put out, the type of product that you were [465] describing?

A. Yes. I think the groundwork had been done

(Testimony of Horace O. Smith, Jr.)

on it, evidently, and it was not listed in this particular dealer price sheet.

Q. And at the end of 1947, did Schalk Chemical Company have—had it acquired the formula for that product, tile cement?

A. The formula was a material that was, as I recall, made by the Continental Chemical Company in Los Angeles.

Q. Yes. Now, had you acquired the formula from Continental Chemical Company?

A. No. We purchased the ready mix material, the package.

Q. Well did you put the product on the market in 1947?

A. I don't recall, Mr. Hall. I think the records should show that clearly.

Mr. Hall: Your Honor, may I have the Exhibit 33?

The Court: What is it?

Mr. Hall: It is the notes of the Biltmore Hotel meeting.

Q. (By Mr. Hall): Now, in the executive committee meeting that the Court referred to, also, there is a reference to spot remover. Spot remover was put out by Schalk Chemical Company [466] in 1947; is that correct? A. As I recall, yes.

Q. Yes. Now, Mr. Smith, I show you Petitioner's Exhibit 33. I ask you if you attended a general sales meeting at the Biltmore Hotel, held on November 26, 27, 28, 29, 30 and December 3, 1945?

A. Yes.

(Testimony of Horace O. Smith, Jr.)

Q. Now, on the first page of that exhibit, it states it was decided to market the following products: The first product is plaster pencil, which we have already discussed, and the second product was spot remover, which we have already discussed.

Now, there was a liquid paint brush cleaner?

A. Yes.

Q. Now, did you agree that that product should be produced by Schalk Chemical Company?

A. I believe so; yes, sir.

Q. Did you implement the production, did you start the development of that product, Mr. Smith?

A. No, I don't believe I did.

Q. Now, how about the next one, which is described as all in one household cleaner. Did you agree that Schalk should produce that, market, or Schalk should market that product?

A. Apparently so, from these records here. [467]

Q. Did you do anything to implement that agreement? A. Not that I recall.

Q. And the next item is a varnish remover and that is what we have discussed before; is that correct, the paint and varnish remover? A. Yes.

Q. Which you did nothing to implement?

A. That is right.

* * *

Q. (By Mr. Hall): Mr. Smith, the executive committee, as I recall your testimony, did not solve the situation because of lack of harmony; is that correct? A. I believe so.

Q. That was lack of harmony between you on

(Testimony of Horace O. Smith, Jr.)

the one hand, and Mr. and Mrs. Farman on the other hand; is that correct? A. Yes.

Q. Mr. Smith, do you recall a meeting between you [468] and your wife, Mr. and Mrs. Marlow, Mr. and Mrs. Baker, in December, 1945?

A. Very vaguely.

Q. Yes. I believe it was on a Sunday and at the home place? A. It could have been.

Q. Was the tentative arrangement different than the executive committee suggested at that time?

A. I do not recall.

Q. Was it discussed at that meeting that you would have an eight year contract of employment with the company?

A. I don't recall the details, if there were any.

Q. Do you recall that that type of arrangement was ever discussed? A. I think there was, yes.

Q. And do you recall that the supervision of the trust was proposed to be transferred to your mother?

A. I don't recall those details, frankly.

Q. Now, Mr. Smith, I refer you to Respondent's Exhibit J, which is volume 4 of the minute books of Schalk Chemical Company, and a letter dated December 9, 1946, addressed to you from Mr. Rausch.

Do you recall that letter? That is the letter that is inserted at page 283 of Respondent's Exhibit J.

A. Yes, I recall this letter. [469]

Q. Yes. Well, at the meeting that commences, the minutes of which are on page 283, there, Mr.

(Testimony of Horace O. Smith, Jr.)

Smith, were you in favor of declaring an extraordinary dividend at that time?

A. In line with Mr. Rausch's letter, apparently I was.

Q. Did you recommend it to the board?

A. That I don't know. I haven't read the minutes.

Q. Now, if you will turn to page 284, towards the bottom you will note that it states the secretary thereupon announced that in view of the controversy which had arisen, it seemed best to hold said meeting—meaning the shareholders meeting—on a particular date for the purpose of electing—it says shareholders. I believe it means, it is supposed to be directors. A. Shareholders.

Q. What controversy was that, Mr. Smith; do you recall? A. No, I don't.

Q. Well, do you know who was at the meeting at which the extraordinary dividend was declared?

A. Mr. Henry J. Rausch, Mrs. Farman and Mr. Farman, and Mr. Wackerbarth, as I recall.

Q. Was Mr. and Mrs. Marlow also there?

A. I don't recall if they were at that meeting or [470] not.

Q. Was Mr. or Mrs. Baker there?

A. I don't recall that, no. Evidently Mr. Guthrie was there and Mrs. Marlow, Mr. Marlow and Mr. and Mrs. Baker.

Q. Now, that is the first occasion that I have seen in these minutes when the whole family was present, Mr. Smith. A. Yes.

(Testimony of Horace O. Smith, Jr.)

Q. According to the minutes. Now, why were the family present on that date?

A. That I don't recall.

Q. Was there opposition to the dividend?

A. That I don't recall either.

Q. Is it possible that there was opposition?

A. There could have been, yes.

Q. Do you know of any other reason for the family being present?' A. I don't believe I do.

Mr. Hall: Your Honor, may I have Petitioner's Exhibit 16 and Petitioner's Exhibit 22, and I hope I have the right ones this time.

Q. (By Mr. Hall): Mr. Smith, I believe it was your testimony yesterday that you recalled no proposal under which the corporation would pay you any part of the moneys that were [471] eventually paid to you; is that your testimony?

A. I am not sure. I don't recall, Mr. Hall. That was 12 years ago.

Q. Yes. Well, I hand you Petitioner's Exhibit 22, which is a letter dated September 12, 1947, addressed to Guthrie, Darling and Shattuck, attention Mr. Olson. A. Yes.

Q. Does that letter bear your signature?

A. Yes.

Q. Now, referring to the first paragraph, it states, "I have studied the plan proposed by you for a settlement of the controversy between Hazel I. Farman, Evelyn Marlow, Patricia Baker and myself," and would you read the next paragraph to yourself?

(Testimony of Horace O. Smith, Jr.)

Does that refresh your recollection?

A. Yes, it does.

Q. Apparently there was a proposal made that Schalk Chemical Company in some form pay you the money that you eventually got; is that correct?

A. That is correct, I believe.

Q. Now, are you familiar with this letter; have you read a copy of it recently?

A. No, I haven't, no.

Q. Would you read the letter in full, please?

A. Okay. [472]

Q. Now, is your memory refreshed as to the contents of the letter? A. Yes.

Q. I believe your testimony was yesterday that the $45,000 that you eventually received was for the purchase of your beneficial interests in the trust; is that correct? A. Yes.

Q. Now, this letter refers first to the payment of a sum of $25,000 in cash? A. Correct.

Q. Is that correct? A. Correct.

Q. And what was that to be paid for?

A. For, partially for the beneficial interest in the trust.

Q. Well now, I draw your attention, Mr. Smith, to the language commencing at the bottom of page one of the letter, which is Petitioner's Exhibit 22, it says, "in consideration of the foregoing, I am to receive the sum of $25,000 in cash, certain releases, and a dismissal of the Marlow case."

Now, by the "foregoing," this letter immediately prior to that, you, in the letter state, "I will deliver

(Testimony of Horace O. Smith, Jr.)

to you—" that is to Mr. Olson— "resignations of Mr. Rausch, Mr. Wackerbarth and Mr. Smith, as members of the board of [473] directors of Schalk, and resignation of Smith as supervisor of the trust."

Now, is that what the $25,000 was for, was that your intent?

A. Not necessarily the intent. The purpose of the $25,000, as I understood it, was to apply on the purchase of my beneficial interest in the trust.

Q. Well, on page 2 of the letter you state, "in addition to the foregoing, I will grant your clients an option to buy all stock owned by me in the Schalk Chemical Company, on December 29, 1950, at the price of $2 per share, less any dividends paid thereon between now and said date; said option to expire July 1, 1951."

Now, your beneficial interest in the trust was one-sixth, was it not, Mr. Smith? A. Yes.

Q. And that was an offer from your standpoint to give an option to purchase that one-sixth interest; is that correct? A. Yes.

Q. And that was your offer was it, $2 a share, or a total of approximately $32,000, wasn't it, for the stock interest; is that correct? A. Yes.

Q. And that is a total aggregate, the two of them [474] put together of $57,000; is that correct?

A. Yes.

Q. In this letter, the two matters are completely segregated, are they not?

A. It would appear that way, yes.

(Testimony of Horace O. Smith, Jr.)

Q. And, but for the declaration of trust, you would not have been president necessarily, is that correct, Mr. Smith?

A. I believe that is correct, yes.

Q. And by reason of your being supervisor of the trust, that you held control of the company?

A. That is right.

Q. And this letter states, does it not, that you would give up that control for $25,000 in cash?

A. Yes, it does state that.

Q. I hand you Petitioner's Exhibit 16. Are you familiar with that agreement of January 15, 1948, Mr. Smith?

A. Yes, I am familiar with it.

Q. Have you read that agreement thoroughly, or are you familiar with it?

A. I haven't read it for some time.

Q. Did you read it at the time you signed it?

A. Yes.

Q. Did you understand the terms of it at that time? A. Yes. [475]

Q. Now, under this agreement, you were paid $25,000 on January 15, 1948; is that correct?

A. That is correct, yes.

Q. Mr. Smith, I refer you to page 5 of Petitioner's Exhibit 16, and the language on page 5 that states:

"In the event that second parties, second parties being the family, their heirs, successors, or assigns shall fail, neglect or refuse to pay the balance of the purchase price as herein provided, the first parties

(Testimony of Horace O. Smith, Jr.)

shall be released—"first parties being yourself—" shall be released from any and all obligation to sell, transfer, convey, or assign the property herein described, and second parties, their heirs, successors and assigns, shall be released of any and all obligations to purchase said property, or to pay to first party any additional moneys hereunder."

Did you understand that paragraph?

A. Yes, I did.

Q. What does it mean?

A. Simply that if they refused to, should refuse to pay the balance of $20,000, they would be, the second parties would be——

Q. Released, isn't that correct?

A. Released from any obligation.

Q. In other words, they did not have to pay the $20,000; [476] is that correct?

A. That is correct.

Q. Were you concerned whether they would?

A. To some extent, yes.

Q. Well, to what extent, Mr. Smith?

A. To this extent, that I wanted to get the full moneys that were agreed upon out and be free of any connection with the corporation.

Q. Well, if they had not paid you the $20,000, then you would have remained the stockholder; is that correct? A. Yes.

Q. And you would have retained the $25,000?

A. Yes.

Q. Yes. Now, was not the $25,000 then to get you out of control, the same as you expressed in

(Testimony of Horace O. Smith, Jr.)

your letter? A. It could have been, yes.

Q. Now, referring to the same page——

A. Matter of interpretation.

Q. Page 5 of Petitioner's Exhibit 5, it states specifically "this agreement may be assigned by second parties, their heirs, successors, and assigns, at any time during the term hereof."

Did you understand that provision; do you know why that provision was inserted? [477]

A. That in the event of death of my mother or either one of my sisters, they could assign their rights to this document to them.

Q. Was not that provision put in there, Mr. Smith, so that it could be assigned to the corporation? A. That I don't know, Mr. Hall.

Q. Would you say it was not discussed?

A. Not to my knowledge.

Q. Now, I believe you stated that you received a certified check for the $25,000.

A. That is my recollection.

Q. Do you recall the circumstances of why that was a certified check? It was a check on the law firm of Guthrie, Darling and Shattuck, was it not?

A. That I don't recall.

Q. You don't recall the circumstances?

A. No. It could have been on the law firm of Guthrie, Darling and Shattauck.

Q. Did you require that the check be certified?

A. Not as I remember.

Q. Not as you remember. Now, with regard to these two exhibits again, that is Petitioner's Exhibit

(Testimony of Horace O. Smith, Jr.)

22 and Petitioner's Exhibit 16, who advised you to have the moneys lumped in one figure, rather than separately as stated in Petitioner's Exhibit [478] 22? A. I believe it was Mr. Wackerbarth.

Q. What was his advice, Mr. Smith?

A. His advice was that since I had only a beneficial interest in the trust, I had no legal right to sell or assign my stock, which was held by the trust.

Q. Were the figures put together into one aggregate figure for your personal tax reasons?

A. Not necessarily.

Q. Was that part of the advice?

A. That I don't recall.

Q. You have no recollection on that?

A. I don't recall the details.

Q. I understand you reported the $25,000 and the ultimate $20,000 as a capital asset sale transaction; is that correct? A. Yes, yes.

Mr. Hall: No further questions at this time.

Mr. Gardner: Just two or three questions, Mr. Smith.

Redirect Examination

By Mr. Gardner:

Q. Referring to Exhibit 22, in which you apparently send a proposal to Mr. Olson, the figures set out in that exhibit are $25,000 and $20,000, or in some such breakdown; are they not?

A. Yes. [479]

(Testimony of Horace O. Smith, Jr.)

Q. What is the breakdown? A. 25 and 20.

Q. 25 and 20. Now, in your mind, that is your own mind——

A. Pardon. Correct. $2 a share for it, less any dividend paid for my stock in the trust.

Q. Now, in your mind, when you sent that proposal, did you—would you state whether or not it was your intention to contain the entire amount in return for your entire beneficial interest in the trust? A. That was my understanding.

Q. The breakdown was merely to make it clearer; is that right?

A. And to make it possible for them to enter into this agreement.

Mr. Gardner: No further questions.

Mr. Hall: May I have that, Mr. Gardner.

Recross-Examination

By Mr. Hall:

Q. But the intent that you have just stated, Mr. Smith, is directly opposite to what is set forth in this letter, is it not? A. No, I don't believe so.

Q. Well now, I point out again that in consideration of certain things you were to receive $25,000. [480]

A. Yes, on the payment of that I was naturally compelled to offer them my resignation, together with the resignation of Mr. Wackerbarth.

* * *

Mr. Gardner: Call Mr. Wackerbarth. [481]

HENRY O. WACKERBARTH

a witness called by and in behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Mr. Hall: May Mr. Farman be excused, if he wishes to go?

Mr. Gardner: I have no further questions of him.

The Court: He may.

The Clerk: Be seated, please.

Would you state your name and address for the record, sir?

The Witness: Henry O. Wackerbarth. 326 West Third, Los Angeles, California. That is my office address.

Direct Examination

By Mr. Gardner:

Q. Mr. Wackerbarth, what is your occupation, sir? A. I am an attorney.

Q. How long have you been an attorney?

A. Since 1913.

Q. Since 1913? A. Yes.

Q. Do you know, or did you know Mr. Colyear?

A. Yes, sir.

Q. Would you state what your relationship was with Mr. Colyear, and when you first met him, sir?

A. My relationship with Mr. Colyear was as his attorney. [482] I met him many, many years before 1913. The Colyear family and our family were friends many years back before that.

(Testimony of Henry O. Wackerbarth.)

Q. I see, sir. How long did you represent Mr. Colyear as an attorney?

A. Since 1913, up to the date of his death, August 11, 1943.

Q. And during that time, did you have any occasion to represent Mr. Colyear in connection with the Schalk Chemical Company? A. I did.

Q. Would you state, sir, your first relationship with that company?

A. With the company would be when I became secretary of the company.

Q. When was that, sir?

A. It must have been 1931, the exact date I cannot say.

Q. 1931? A. I think that is 1931.

Q. Were you instrumental in drawing up a trust arrangement providing for the control of that company?

A. I did not draw the trust. Frank Thomas, who was the attorney for Frank McGinnis, drew the trust.

Q. I see. But then you became associated with the company [483] as a secretary, did you say?

A. As the secretary of the company when Mr. Colyear went in control of it.

Q. When he took over as supervisor of the trust?

A. That is right. I went in as secretary at that time.

Q. You went in as secretary at that time?

A. Yes, sir.

(Testimony of Henry O. Wackerbarth.)

Q. And how long did you remain as secretary of Schalk Chemical Company?

A. Until 1948, I think the minutes are, when the agreement was entered into, which has been referred to here as, I think, January 15, 1948, that was about the time that I——

Q. I see. Now, during the early years, that is 1931 up to say 1942, as secretary of Schalk, did you discuss the corporate business with Mr. Colyear?

A. Oh, yes, many times.

Q. Many times?

A. Oh, yes. We held the meetings at my office.

Q. Now, during the period say 1931 to 1935, did you have any discussions with Mr. Colyear, as secretary of the corporation, regarding the possible employment of Mr. Farman? A. I did.

Q. And what was the result of those discussions, sir? [484]

A. Mr. Colyear stated to me that he would not under any circumstances permit Mr. Farman to come into the company.

Q. What was his reason, sir?

Mr. Hall: I object, your Honor, on the ground that it is hearsay, the reasons of Mr. Colyear, unfortunately he is deceased, and I do not have the opportunity to cross-examine him on his opinion as to Mr. Farman.

The Court: Sustained.

Mr. Gardner: If the Court please, this is—he is speaking now in his corporate capacity, rather than any individual. This is the result of the corporate

(Testimony of Henry O. Wackerbarth.)

discussion regarding the employment of Mr. Farman.

A corporation is represented by its officers and they are now talking; I think it takes it out of the realm of hearsay, your Honor.

The Court: I will adhere to my ruling.

Mr. Gardner: All right.

Q. (By Mr. Gardner): Do you know whether or not Mr. Farman attempted to gain employment with the corporation during the period 1931 to '36, sir?

Mr. Hall: Of your own knowledge.

The Witness: Only the discussions in which Mrs. Farman had stated that she wanted him in the company, [485] brought into the company. That was all that I heard, and that was at meetings of the shareholders there, and that was early in the history of Mr. Colyear's management of the company.

Mr. Gardner: I see, sir.

Q. (By Mr. Gardner): Were subsequent requests made to put Mr. Farman into the company, do you know?

A. Well, no. I think the matter was dropped, because Mr. Colyear to do it, refused to permit him to come into the company. It was then dropped and that was the time that a breach then developed between Mrs. Farman and Mrs. Smith, at that time, and Mr. Colyear, because he wouldn't bring her into the company.

Up to that point of time, Mr. Colyear had been a very loyal friend of hers, apparently on both sides, because at their request he had been appointed

(Testimony of Henry O. Wackerbarth.)

guardian of the children in place of Mr. Frank McGinnis. There was a very close tie-up at the time that Mr. Colyear refused to bring Mr. Farman into the business.

Q. From that time there was a breach?

A. That is correct.

Q. Personal breach. Now, let's go on up to the year 1946, sir, during the year 1946, Mr. Horace O. Smith, Jr., was the president of Schalk and the supervisor under the trust; is that correct, sir? [486] A. That is correct.

Q. Now, can you state whether or not there were repeated efforts in 1946 to have Mr. Smith, Jr., removed as president and as supervisor by the other stockholders? A. Yes. The answer is yes.

Q. There were repeated efforts; is that correct, sir?

A. Yes, sir, more than, I would say more than efforts. There were requests that he step out.

Q. Now, of your own knowledge, do you know whether these requests started prior to 1946?

A. Yes, they did.

Q. Did they start prior to 1945?

A. Well, I would say they started in 1945. That would be my first recollection of them. It was before these actions were taken in 1946. Yes. It had been going on for some time; they wanted him out.

Q. They wanted him out?

A. Yes. When I say they, I am referring to Mrs Farman primarily.

Q. And who did the talking for Mrs. Farman?

(Testimony of Henry O. Wackerbarth.)

A. Well, Stanley Guthrie was her attorney.

Q. I see. A. Yes.

Q. And was she also represented in part by Mr. [487] Farman?

A. I didn't hear that.

Q. Was she also represented in part by Mr. Farman?

A. Mr. Farman didn't come into the picture until about the time that he was, he went on the board. Up to that point of time, I don't think Mr. Farman attended a board meeting, and if you want the date for that, I will give it to you.

Q. It is not too important that we have that date, Mr. Wackerbarth. It was in 1945, I believe, September.

Now, to go back again, for just two questions regarding Mr. Colyear, what other interests did Mr. Colyear have that you knew of, Mr. Wackerbarth?

A. Mr. Colyear founded the Colyear Motor Sales Company prior to 1912. Up to 1912 his business was the sale of motor trucks and automobiles.

In 1912, or '13, probably '13, they changed their business, got away from the sale of automobiles, and motor trucks, and went into the parts business, automotive parts. He also had a warehouse here, warehouse business, operated the Colyear Van and Storage Company, and he also had a furniture store on Main Street.

That besides other, quite a few pieces of real property, which he owned here and looked after.

(Testimony of Henry O. Wackerbarth.)

Q. Do you know Mr. Colyear's reputation as a businessman, [488] sir?

A. Well, he was always considered to be a very able and astute businessman.

Q. Now, you handled the affairs of many businessmen, don't you, sir, as an attorney?

A. Quite a few, yes.

Q. In your opinion, where do you place Mr. Colyear?

A. Mr. Colyear was one of the ablest businessmen that I ever met.

Q. Now, when young Mr. Smith came to work for the corporation in 1936, do you know whether or not Mr. Colyear and Mr. Lieben were considering grooming him for the presidency of the company some day?

A. That was the purpose in bringing him into the business, yes, so that he could take over at the time that Mr. Colyear stepped out.

Q. And it was their purpose to train him for that job; is that correct?

A. That is correct; that is correct. That is the reason he brought him into the business while he was still alive.

Q. Referring to Exhibit J, minutes of the corporation of Schalk Company, board of directors for June 24, 1942, would you state whether or not, sir, you are the one that prepared those minutes? [489]

A. I did, I wrote the minutes.

Q. And——

(Testimony of Henry O. Wackerbarth.)

A. Signed them and Mr. Colyear signed them also, as president.

Q. Now, these start at page 230 of Exhibit J, don't they? A. That is correct.

Q. And going over to the middle of the page, 231, sir, just past the middle,—wait a minute, I have the wrong page here.

I intended to refer to the minutes for the date September 1, 1942, a meeting of the board of directors of Schalk Company, page 233 of Exhibit J, going to page 235, approximately the middle of the page.

It is stated there that the chairman thereupon reported that he felt Horace O. Smith, Jr., had had sufficient training in the business of the Schalk Chemical Company to assume chart of the business, and the presidency of the corporation, and that he, Mr. Colyear, desired to resign as president, but to retain his position as one of the directors of the company, as well as the supervisor. Horace O. Smith, with the Union Bank.

Do you recall writing that, sir? A. Yes, sir.

Q. And the chairman who made that statement [490] was Mr. Colyear; is that correct?

A. That is correct.

Q. Do you consider Mr. Colyear, I mean, from your association with him, and from your association with other businessmen, as a man of keen business ability and one who would certainly know whether or not a person had had sufficient training?

(Testimony of Henry O. Wackerbarth.)

A. Yes. Mr. Colyear employed hundreds of people in his various businesses.

Q. Now, at that time, was it also your opinion or would you state whether or not it was your opinion that Mr. Smith was ready to take over as president of Schalk?

A. I would say that Mr. Smith was ready to take over as president of the Schalk Chemical Company under Mr. Colyear's supervision, and in association with Mr. Lieben, I would say yes.

Q. Well, now, Mr. Lieben, what sort of a person was Mr. Lieben, sir?

A. Mr. Lieben was a very able businessman, and had been with the Schalk Chemical Company over 20 years at that time.

Q. Now, would it be your recommendation that Mr. Smith, Jr., if he took, when he took over the company, and when he did take over the company, listen [491] and work closely with Mr. Lieben?

A. Yes. It was understood that he would and I would say that he did.

Q. And that was the desire of Mr. Colyear, too, wasn't it? A. That is correct.

Q. Mr. Wackerbarth, I want to refer you to page 283 of Exhibit J, minutes of the board of directors of Schalk Chemical Company for the 27th day of December 1946. Would you examine those minutes, sir, and see if that is your signature?

A. That is my signature, yes.

Q. Did you prepare those minutes?

A. I did.

(Testimony of Henry O. Wackerbarth.)

Q. Would you refer to the bottom of page 283, and state for the record that last sentence on that page 283 of Exhibit J? A. I have read it.

Q. Would you read it aloud, sir?

A. "After considerable discussion with reference to the amount of dividend to be declared, director G. I. Farman presented the following resolution, and moved its adoption."

Q. That relates to what, sir?

A. A resolution for a dividend in the sum of $42,000.

Q. Now, do you recall now whether or not Mr. Farman [492] made——

A. Mr. Farman made that motion.

Q. Now, sir, going to the agreement, that is the agreement of January, 1948, whereby Horace O. Smith, Jr., steps out as supervisor, would you state, sir, when approximately the preliminary negotiations resulting in that agreement began?

A. They began the date—I would have to get from, from the file of Marlow versus Union Bank to get the exact date. But the occasion was the sustaining of the demurrer which I interposed to the complaint to remove, to set aside the trust and remove the supervisor and Mr. Smith.

After the Court has sustained that demurrer, then the matter of discussion of settling this matter was presented.

Let me put it this way, it was presented in earnest; there had been discussions before that about Bob getting out.

(Testimony of Henry O. Wackerbarth.)

Q. In fact, that, did that continue all during the year 1946, or do you recall?

A. Well, I wouldn't want to pinpoint as to any time. It is a matter that had been going on for a considerable period of time.

Q. Now, how many causes of action were in this complaint to remove—— [493]

Mr. Hall: I object to that question, your Honor, on the grounds that it is immaterial. The complaint is in evidence.

The Court: The complaint is in evidence.

Mr. Gardner: I realize it is, your Honor. I would like to bring out the fact that——

The Court: You may show it to the witness, if you wish.

Mr. Gardner: He might recall it.

Q. (By Mr. Gardner): Do you recall?

A. Well, I don't recall. There was probably a dozen somewheres around that. There was probably around 10, 12 or more.

Q. And your demurrer as to each one of these was sustained; is that correct?

A. That is correct; that is correct.

Q. Now then, from that point on, you began to negotiate in earnest, as you might say, for some settlement of this problem? A. That is right.

Q. You represented Mr. Smith, Jr., in these negotiations?

A. That is correct; that is correct.

Q. And could you state whether or not there was ever [494] considered during these negotiations now

(Testimony of Henry O. Wackerbarth.)

resulting in the final agreement of January, 1948, was there ever any consideration made as to, that Horace Smith, Jr., might purchase the interests of the other stockholders; do you recall that?

A. I don't recall any discussion of Horace Smith ever purchasing the interest of the others.

Q. I see. Now, as to the discussions relating to Horace Smith selling his beneficial interest in the trust, do you recall whether or not there were any discussions that the corporation purchase Mr. Smith, Jr.'s beneficial interest in the trust?

A. There was a matter presented, but so far as our position was concerned, we didn't consider it. That is, we didn't consider that we would enter into any such agreement for the corporation to purchase Horace Smith's interest in that trust.

Q. What was the reason, sir?

A. Well, primarily that it wasn't a matter that the corporation was interested in, and Horace Smith controlled the board of directors, and he couldn't very well sell his interest in a non-assignable trust to the corporation for a sum of money, and ask the vote and approval of the directors that he controlled, because he did control three directors. For that [495] reason, we wouldn't consider any sale to the corporation, of the corporation.

Q. Now, the last document in evidence, 37, please, your Honor.

I show you Exhibit 37, sir, and ask whether or not you recall receiving that from the representatives of the family?

(Testimony of Henry O. Wackerbarth.)

A. I don't recall. I have no copy of this, let's put it that way, and if you will permit me to read it first. I don't recall.

Q. Yes, surely, read it. A. I have read it.

Q. Do you recall receiving that document from Mr. Olson?

A. I don't recall receiving it, no. That is, at this time I don't recall receiving it.

Q. Do you recall whether or not there was a discussion along those lines, sir?

A. My recollection that there was something said about the corporation purchasing, but we would not consider that at all.

Q. Therefore, the discussion that you had relating to whether or not the corporation would purchase it was very brief? A. Was dropped, yes.

Q. And from that time on, the question of the sale [496] of Mr. Smith's beneficial interest in the trust was strictly between whom?

A. Between Mr. Smith on one side, and the family on the other. The family being Mrs. Farman, primarily, and the daughters, the two girls both seemed to be working with their mother, so that we assumed it was with them, too.

Q. Now, during these negotiations, how many would you say you had, sir, from the time that the demurrers were sustained in the prior suit, and the time the agreement was finally executed in January of '48?

A. Well, there were very few. I don't remember

(Testimony of Henry O. Wackerbarth.)

how many, but there were very few conferences that we had in connection with it.

Q. Now, were these conferences attended by the members of the family; that is, Mr. Farman, Mrs. Farman?

A. No. Mr. Guthrie was the one that I discussed it with.

Q. You did not discuss it with the members of the family?

A. I don't think—I am not, I am sure I didn't discuss it with Mr. Farman, and I don't think Mrs. Farman ever entered into the negotiations. They were primarily with Mr. Guthrie.

Q. I see, sir. In your conversations with Mr. Guthrie, you were talking solely about the members of [497] the family acquiring beneficial interest of Horace O. Smith, Jr., in the trust; is that correct?

A. That is correct.

Mr. Gardner: Exhibit 16, please.

Q. (By Mr. Gardner): Mr. Wackerbarth, I hand you Exhibit 16, and ask if you have seen that document before, or a document similar to that?

A. I saw this document at the time it was signed, signed over in Mr. Guthrie's office.

Q. You were present at that time, sir?

A. Yes.

Q. Is this the document that you, or did you prepare the document? A. I did not, no.

Q. Did you assist in the preparation of it?

A. No. Mr. Guthrie prepared it. That is, I pre-

(Testimony of Henry O. Wackerbarth.)

sumed he prepared it. It was presented to us at a meeting over at his office.

Q. Now, was this document in accordance with certain agreements that you had made with Mr. Guthrie in an effort to settle this dispute?

A. This was to carry out the discussion which Mr. Guthrie and I had had about how the matter could be settled. [498]

Q. And actually, you are talking about the physical preparation was not done by you?

A. No, I did not, no.

Q. But the content of the agreement you assisted in that?

A. I discussed it with him, as to what Horace Smith was willing to do.

Q. I see. Now, relating to the amounts set forth in there, that is $25,000 to be paid as of this date, that is the date the agreement was executed, and the $20,000 to be paid at a subsequent date after the trust expired, what was your understanding as to the purpose of the payment of the total sum of $45,000, sir; what were the purchasers getting?

A. They were, Horace Smith was to step out of the corporation, completely out of the corporation. He was to step out as supervisor of the trust, as president of the company, as an employee of the company, and he was to give up his interest under the trust. The trust was a non-assignable trust, and he couldn't assign his interest in it.

Therefore, he could only transfer his interest if, as and when a trust terminated.

(Testimony of Henry O. Wackerbarth.)

Q. Now, you were familiar with the business at that time, were you not, Mr. Wackerbarth?

A. Yes. I was secretary of the corporation for many [499] years. I didn't go down to the plant, if that is what you mean. I have been there a few times, but I didn't go down there and take any part in that.

Q. No. I am sure you didn't. But you were present at all the board meetings, were you not, sir? A. I was.

Q. And you did take an active part in the meetings?

A. And the discussions, yes. I was a director there for a number of years.

Q. So, you knew very well the business trend and so forth in relation to that corporation?

A. Yes, I would say I did.

Q. Now, at the time that Mr. Smith, Jr., executed that agreement in January of 1948, what would you say the value of the corporation, Schalk, itself, what was the value of the stock at that time, sir?

Mr. Hall: Objected to, your Honor, on the ground of this witness has not been qualified to state an opinion on that subject.

The Court: Sustained.

Q. (By Mr. Gardner:) Were you familiar, sir, with the assets, liabilities and possibilities of this company?

A. Well, I was familiar with the assets and liabilities, and familiar with what the corporation

(Testimony of Henry O. Wackerbarth.)

had [500] been doing since I was secretary, in the way of sales and profits.

Q. Were you familiar with whether or not the corporation had an extensive good will throughout the country? A. The corporation——

Mr. Hall: That is objected to on the ground it calls for the conclusion of the witness.

The Court: He may answer.

The Witness: The corporation had done a considerable amount of advertising over a long period of years, and it was the concensus of the directors there that they had established a good will for their products, an extensive good will for the products.

Q. (By Mr. Gardner): Do you know whether or not this good will was shown on the books of the corporation?

A. I don't think that it reflected anything on the books, as I recall.

Q. And actually, it was one of the most valuable assets they had, wasn't it?

A. I would—well, of course, their products were valuable assets, but I would say that the fact that they had done this tremendous amount of advertising, was certainly an asset of the business. [501]

* * *

Q. Well, Mr. Wackerbarth, do you have any idea, state whether or not you have any idea as to the possible price that could be obtained from the sale of all of the stock of Schalk as of January, 1948, sir.

A. No, I wouldn't want to say. I had never had

(Testimony of Henry O. Wackerbarth.)

taken any part whatsoever in trying to dispose of the assets of the business. I had heard discussions, if that——

Q. No, I don't want that. A. Sir?

Q. I wouldn't want that.

A. That is all I could say, that I know, sir, discussions that I had heard about it.

Q. I see. Referring once again to page 283 of Exhibit J, and the meeting of December 27, 1946, it appears that there were a great many people present at that meeting, sir.

A. Stanley Guthrie was there, as attorney for Mrs. Farman; and Mr. Farman, Evelyn Marlow, and Fred W. Marlow, her husband were there; Patricia Baker and J. C. Baker, her husband, was there, and Henry Rausch was present at the meeting. [502]

Q. Now, do you know whether or not there was any disagreement as to the $42,000 dividend stated in those minutes?

A. There was no disagreement as to the amount of the dividend; no, sir.

Q. Did Mr. Farman say anything against it?

A. He did not oppose it at all. He made the motion for the payment of the dividend.

Q. And did all of the directors vote in the affirmative, sir? A. They did.

Q. Do you know the purpose or the reason for all of these people being present at this meeting?

A. I can only answer that by what occurred at the meeting, if that helps any.

(Testimony of Henry O. Wackerbarth.)

Q. What did occur?

A. As to why they came, I don't know, but I know what they did.

Q. What did they do, sir?

A. Mr. Farman, Mr. Marlow led off there, and wanted to know why this business was being run under a trust, and I told him that that trust had been entered into many years before. And that up to the present time, I had never heard of any objection to it.

And he said that it was very distasteful to the [503] family and that he didn't know why this business had run under a trust that was so unfair, and distasteful to the family.

And I said that that was a matter that I didn't see any reason of going into it at this time, because is had occurred many years before. And it had occurred as a result of avoiding a long-drawn out lawsuit.

And he said that he was going to go into that matter and that he didn't believe that it was a good trust, that he was going to try and set it aside, upset it.

And that was the—there is a reference here that so far as I know was the only time that Mr. Marlow was ever present at the board of directors meetings.

Q. Thank you, sir. Just one further question regarding the management of Horace Smith, Jr., that is the presidency of Schalk Chemical Company.

From 1942 to 1947, at the time he was disposed

(Testimony of Henry O. Wackerbarth.)

or sold his interest in 1948, what was your opinion, sir, of his tenure as president and as supervisor?

A. The business progressed. It was going along well. They were paying dividends, and making profits, and the only objection was from his mother, and I think his sisters didn't want to run it, but that was the only objection from that end of the family.

Q. In 1947, they didn't make very much money, in [504] fact there, that was a loosing year, wasn't it, Mr. Wackerbarth?

A. Yes. That was a year there that one of the questions involved was the matter of advertising, and the purchase of some new equipment, and I believe the expenses of the officers was very heavy that year, as I recall it.

Q. That was in 1947?

A. 1946 and '7, there was considerable expense. They had a very heavy advertising expense that year.

Q. Was that in 1947? A. 1947, yes.

Q. Was that a part of the policy to keep its products before the public?

A. Yes. They always maintained a lot of advertising; all they had to sell was some products there, and their competition was always heavy. They had to advertise heavily and that was always a representation which I was given to understand was made to the trade that they would advertise heavily.

Q. Well now, just another point. Going back to

(Testimony of Henry O. Wackerbarth.)

the earlier years, do you know whether or not dividends were declared in almost every year?

A. I think dividends were declared almost every year, if I recall rightly. I would like to see the minutes, but I think you will see——

Q. There was a practice—— [505]

A. There was one year there was a loss, and I think they still paid a dividend that year.

Q. This was what practice——

A. Yes, yes. The family had to live on that.

Q. Yes. A. Yes.

Q. Did Mrs. Farman state that in the meeting——

Mr. Hall: I object, your Honor. That is not within the knowledge of this witness.

The Witness: It was said there at the meetings, if that was, helps any, that was the only source of income, if that helps any.

The Court: Has the witness—if the witness heard Mrs. Farman so state, he may so testify.

Mr. Hall: He has so testified.

The Witness: Yes, that is correct.

The Court: His testimony will remain in the record.

Mr. Gardner: Did you get his answer?

The Reporter: Yes.

Q. (By Mr. Gardner): During the period, entire period that you were secretary of this corporation, did you notice whether or not the daughters took any part at all in the management as reflected

(Testimony of Henry O. Wackerbarth.)

by attendance at board meetings, and participation therein? [506]

A. Yes. They started coming to the meetings. Well, Mrs. Marlow started coming to the meetings, I think, in 1945 was when she started coming.

If you want to know the first time that she appeared, I think I can tell you.

Mr. Hall: It was in 1936, I believe, Mr. Wackerbarth.

The Witness: Well, if she appeared in 1936, then she didn't come for a long, long period of time after that. She went on the board in 19——

Q. (By Mr. Gardner): Are you referring to a file where you——

A. That is my copies of the minutes.

Q. That is your copy of the minutes?

A. Yes.

The Court: The minutes are in evidence, and they will speak for themselves.

Mr. Hall: That is right.

Mr. Gardner: All right, sir.

Q. (By Mr. Gardner): Now, would you state whether or not the—Evelyn took an active part in the discussions?

A. Yes. She spoke up many times when she was a director. She took an active part in it. She went on April 26, 1944, is when she went on the board.

Q. April 26, 1944, sir? [507] A. Yes.

Q. And from that time on, did she take an active part, if you remember?

A. Well, she went off at a later time, her stock

(Testimony of Henry O. Wackerbarth.)

was transferred to Mr. Farman, and he went on. She stepped out and Mr. G. I. Farman went on.

Mr. Garner: No further questions.

Cross-Examination

By Mr. Hall:

Q. Mr. Wackerbarth, how long have you represented Horace O. Smith, Jr., individually?

A. I think the first representation of Horace Smith was when they filed suit against him in 19—April, 1947.

Q. Well, did you—I don't mean to ask an unfair question—you represented him, did you not, at the time of the, when the executive committee was set up in 1945?

A. No, I was representing, I was secretary of the corporation, representing all of them. I wasn't representing him in particular. Horace Smith did ask me questions from time to time.

Q. Did you ever write a letter to Mr. Guthrie and set out the terms of the settlement at that time by implementation of an executive committee? You have no recollection on that, Mr. [508] Wackerbarth?

A. As to whether or not I wrote a letter to Stanley Guthrie?

Q. Yes, concerning the settlement or proposed settlement, at that time, between Mr. Smith and the rest of the family?

A. I could have. I want to look through my file and see if I have one.

(Testimony of Henry O. Wackerbarth.)

Q. No? A. No, but I could; yes.

Q. We have it here in evidence.

A. All right.

Q. Petitioner's Exhibit 15. I just want to recall it to the witness.

This is the letter I refer to. It is Petitioner's Exhibit 15, and it concerns the settlement under which the executive committee was to be set up.

Now, you were representing Mr. Smith individually at that time, were you not?

A. Well, Horace Smith did talk to me. There is no question about that. The first time that I ever represented him in any litigation, when they set aside the trust, but he did turn to me, if that is what you mean.

Q. I am speaking of the dispute between the family members and the negotiations, and attempts to settle that dispute. Did you represent Mr. Horace O. Smith, Jr., [509] individually throughout those negotiations?

A. He discussed this matter with me. I was never employed by Horace O. Smith; no, the answer is no on that. He did discuss those matters with me from time to time; that is correct.

Q. Now, at whose request was Mr. Smith employed by Schalk Chemical Company?

A. At whose request?

Q. Yes. A. Mr. Colyear.

Q. And who requested Mr. Colyear to employ Mr. Smith?

A. My recollection is that his mother wanted him

(Testimony of Henry O. Wackerbarth.)

in the business. That is early in the inception, and Mr. Colyear held off for a long time in bringing him into the business.

Q. But there was insistence by Mrs. Farman?

A. That he be brought into the business.

Q. Yes.

A. That is the way I recall it, that she wanted him in the business.

Q. Now, regarding this, your discussion with Mr. Colyear concerning possible employment of Mr. Farman, I believe it was some time in the years 1931 to 1935; were the discussions, or requests that Mr. Colyear had, did they emanate from Mrs. [510] Farman? A. That is correct.

Q. Did Mr. Colyear to your knowledge, or did you at any time discuss it with Mr. Farman?

A. No.

Q. Did Mr. Farman make a request for employment?

A. Not to me and I never heard him make one.

Q. Those were all requests made by Mrs. Farman? A. That is correct.

Q. Mr. Wackerbarth, referring to Petitioner's Exhibit 16—— A. Yes, sir.

Q. ——which is the settlement here——

A. Yes, sir.

Q. ——how much of the total amount of $45,000 was for Mr. Smith's one-sixth of the stock interest?

A. There was no break-down to the best of my knowledge, because there was a clause which I insisted be put in there, and that reads as follows:

(Testimony of Henry O. Wackerbarth.)

"The entire purchase price of the property herein agreed to be sold by the first party to the second party, shall be the sum of $45,000, less any distributions made by first party from said trust as herein provided; and the sum of $25,000 paid by second parties, as a consideration to first party for entering into this agreement shall, in the event second parties, their heirs, successors, or [511] assigns, comply actually and promptly with all the terms and conditions thereof be applied toward the said purchase price."

Q. All right. Now, reading, if you will, look at the last part of that paragraph that you read, Mr. Wackerbarth. A. Yes, sir.

Q. It says that the sum of $25,000 shall apply on the $45,000 if the second parties comply with this agreement; is that correct?

A. That is what it says.

Q. What is your understanding, supposing the second parties had not paid the $20,000 in escrow in 1951, is it your understanding that by reason of this paragraph that the obligation to pay the $20,000 would be enforceable?

A. No, I don't, no. My recollection of this, I said I haven't seen this since the day in Mr. Stanley Guthrie's office up till today, but my recollection is that they could default on that $20,000.

Q. In other words——

A. Bob would then own it, would then own his stock.

Q. Then he would own his stock?

(Testimony of Henry O. Wackerbarth.)

A. That is correct.

Q. Isn't the $20,000, was payable for the stock?

A. No, no, no. It was a lump sum of $45,000, was [512] the amount which they were to pay for him stepping out of the picture, and giving up his stock.

Q. All right. But breaking it down, they didn't have to pay the $20,000 and they did not have to pay, acquire his stock interest; is that correct?

A. I think that is correct. If you will give me an opportunity, I will look at this, though, and—but that is my recollection of it.

Q. Take an opportunity.

A. All right.

Well, are you ready for me?

Q. Yes.

A. You have a clause here on page 2 that provides that on or before 30 days before the termination, that they will pay the $20,000.

Then you have another clause in here that in the event that they don't pay that amount of money——

Q. They are released?

A. Well, wait a minute. It says that that, if, they said escrow conditions shall provide that if the second parties or their assigns fail, neglect or refuse to deposit that money within the time and subject to the conditions herein contained, the balance remaining of the aforesaid purchase price then all property and documents deposited by the first party in said escrow shall immediately [513] be returned to him.

(Testimony of Henry O. Wackerbarth.)

That was a provision with reference to escrow instructions.

Then you have got another clause here which says in the event the second parties, their heirs——

Q. We have read that into the record before.

A. Well, I haven't, but that is the one I am referring to.

Q. If they don't pay it, the second parties then they are released of any obligation to pay it; that is the $20,000, is that correct?

A. Well, I think you have got to read something else into that in order to say that they shall be released.

Q. But you stated before, Mr. Wackerbarth, that they did not have to pay the $20,000, that was my recollection.

A. Now, you have asked me, and I, I have told you, I want to look at the agreement, you have this clause here in the agreement, "In the event the second parties shall fail, neglect or refuse to pay the balance of the purchase price, the first parties shall be released of all obligation to sell."

Q. Yes.

A. And the second parties, and their successors, and assigns, shall be released from any and all obligations to purchase.

I think that under that agreement it would [514] be my understanding that Bob would have to take an affirmative position there and repudiate the agreement, and they would be released. That is the way it looks to me.

(Testimony of Henry O. Wackerbarth.)

Q. But they would retain, Bob Smith would retain the $25,000?

A. Oh, yes, that is correct.

Q. Now, what was the $25,000 for?

A. That was a down payment.

Q. I hand you Petitioner's Exhibit 22, which is a letter dated September 12, 1947, addressed to Guthrie, Darling and Shattuck, attention Mr. Olson, and signed by Mr. Smith. It is on your letterhead. Are you familiar with that letter?

A. I want to look at it first.

Yes, I have read that letter.

Q. Did you dictate that letter, Mr. Wackerbarth?

A. Well, I would say that I did, yes.

Q. Now, that letter——

A. It was dictated at my office and—go ahead.

Q. Now, that letter clearly segregates the $25,000 and an amount to be paid for the stock; does it not?

A. That is what it says in this, yes.

Q. Now, that letter is dated September 12, 1947?

A. That is correct.

Q. It refers to a plan apparently that was proposed [515] prior to that time by Mr. Olson, and it also refers to an offer which was heretofore conveyed from your side.

A. Well, that was, that was signed by Mr. Smith.

Q. Yes.

A. And apparently he had conveyed that offer and this was a letter which the offer was—to confirm this offer.

(Testimony of Henry O. Wackerbarth.)

Q. You had conferences with Mr. Olson prior to that date, did you not?

A. I don't think I had conferences with Mr. Olson. I think that most of mine were with Mr. Guthrie. Apparently Bob Smith had these conferences with Mr. Olson, because this was a letter here which it shows that he dictated, but I am sure it was dictated in my office, because it was dictated to my secretary, and I am pretty certain I was present.

Q. Well, would Mr. Smith have met with Mr. Olson out of your presence, Mr. Wackerbarth?

A. He could have.

Q. Did he? A. I don't know; I don't know.

Q. Would that be customary, Mr. Wackerbarth?

A. It isn't customary, no. But I don't recall Mr. Olson—most of all these dealings were with Mr. Guthrie, but Mr. Olson handled the litigation, that was very definite. [516]

Q. And he participated in some of the meetings, did he?

A. He could have. I don't recall him being in any meetings, but he could have.

Q. Now, is it your testimony that Mr. Guthrie and Mr. Olson did not propose that the money be paid by the corporation to Mr. Smith?

A. Is it my testimony that they did not propose that?

Q. Yes. A. No. That is not my testimony.

Q. That was their proposition?

A. That was their proposition.

Q. And that was over many months of this negotiation, was it not, their proposition?

(Testimony of Henry O. Wackerbarth.)

A. How long I can't say, but it was never accepted, if that means anything.

Q. Sure. In other words, from your side of the picture, and Mr. Smith's side of the picture, you were insisting that it be between the family members? A. That is correct.

Q. Is that correct? A. That is correct.

Q. And on Mr. Guthrie's side, and the family's side, they were trying to work it out so that the corporation [517] would pay the money to Smith, rather than the individuals?

A. That is correct.

Q. Referring to Respondent's Exhibit J, page 283, the page to which Mr. Gardner referred you to, the meeting at which the extraordinary dividend of $42,000 was declared. A. Yes, sir.

Q. Do you have a recollection, independent of these minutes, Mr. Wackerbarth, that Mr. Farman made the motion to declare the dividend?

A. I wouldn't say that I had any independent recollection, but I do know that those minutes having been written up by me, they were, that was the way it occurred, and if we look at the minutes following that—wait a minute, here.

Q. May I assist you, Mr. Wackerbarth. Here it is, right here, page 289.

A. That was, there was a shareholders meeting that intervened. Then there was another meeting here, which was adjourned. And there is this notation in the minutes, part of the minutes of the meeting of February 19, 1947.

(Testimony of Henry O. Wackerbarth.)

"The president then called the meeting to order, and thereupon the minutes of the meeting held on December 27, 1946, were read. The president thereupon asked if there were any errors or omissions in said minutes, and director [518] G. I. Farman said he wanted to add to the minutes the statement to the effect that the resolution for the payment of a dividend in the sum of $42,000 was offered by him on the recommendation of Mr. Rausch, and that the sum of $42,000 was arrived at as being 70 per cent of the $60,000 net earnings of the corporation.

"Subject to the correction above referred to, said minutes were approved as read."

That took place at that meeting.

Q. Well, did Mr. Farman make the motion according to your recollection only, because Mr. Rausch recommended it?

A. I don't know what was in his mind, but he made the motion at the meeting of December 27.

Q. And you said that at the meeting the amount of the dividend was discussed? A. Oh, yes.

Q. Yes? A. Certainly.

Q. Was there opposition to the amount of the dividend?

A. By no one that I know of. There is no record there of any opposition to it.

Q. Was there any discussion of the dividend as such? A. As to the amount of it? [519]

Q. Well, anything concerning the dividend?

A. None that I recall. There is nothing in the minutes that I——

(Testimony of Henry O. Wackerbarth.)

Q. Well now, after considerable discussion, with reference to the amount of dividend to be declared—— A. Yes.

Q. That is stated on page 283?

A. That is correct.

Q. What was the considerable discussion?

A. As to how much they should declare, because you have got Mr. Rausch's letter.

Q. Yes.

A. And may I look at that. I haven't seen it since that day.

Q. Yes.

A. That was a surtax question arising there, as to the tax in the event they didn't declare the sufficient amount. Well, that was his recommendation.

Q. Who were the directors at that meeting?

A. At the meeting, when the dividends were declared?

Q. How many directors did the company have at that time?

A. Horace O. Smith, Jr., was present; Hazel I. Farman was present; G. I. Farman was present and myself, and—— [520]

Q. That was all of the directors?

A. I would say that is all, because there is no notation here about any directors being absent. However, if you want me to, I will look through the minutes and see.

Q. May I refer you to page 281, which is the matter of the resignation of Mr. Guthrie was presented and not accepted. There was a split vote.

(Testimony of Henry O. Wackerbarth.)

Would you state for the record whether or not Mr. Guthrie's office as director was declared forfeited at that meeting, and for what reason?

A. I would like to look at the minutes, first. I have no independent recollection of that fact.

Q. All right.

A. All right. Now, your question.

Q. Would you repeat it, Mr. Reporter?

(Question read.)

The Witness: I wouldn't say that, no. I would say this, that his resignation was presented, that I made a motion, "Henry Wackerbarth made a motion to accept the resignation, to accept the resignation of Stanley W. Guthrie as director of the Schalk Chemical Company.

"Thereupon, director Hazel Farman and G. I. Farman stated that they would not vote in favor of a motion to accept said resignation." [521]

Q. (By Mr. Hall): Mr. Wackerbarth, please——

A. I will give it to you, "Thereupon, director Wackerbarth withdrew the motion for the reason that the same had not been seconded, and it had become apparent that the same could not be carried."

Q. Yes.

A. And then Mr. Farman made a statement in favor of Mr. Guthrie, which I will read, if you want me to?

Q. No.

A. "Thereupon, the secretary—" that is myself—"called to the attention of the board of direc-

(Testimony of Henry O. Wackerbarth.)

tors that the provision of Section 2, Article I of the bylaws, and stated that under that section, under said section, that the fact that Stanley W. Guthrie ceased to be a shareholder of the corporation caused him to automatically cease to be a director."

Q. Yes. Now, prior to that meeting, Mr. Smith had designated Mr. Rausch to be the shareholder; is that correct?

A. Well, I will have to look it up and see. I assume if you say that is true, it is true.

Q. It states at the top.

A. "The president further stated that shares had been issued to Henry Rausch."

Q. This had been done by getting the shares of [522] stock back from Mr. Guthrie?

A. Yes, that is right, him and/or somebody else.

Q. This statement was made at this meeting, and presented for the purpose of electing Mr. Rausch a director, was it not?

A. Yes. That is what the president suggested here; that is correct.

Q. He was not elected a director at that meeting?

A. He was not.

Q. He was not elected a director at the next succeeding meeting?

A. At a later time he was elected a director, if that answers your question, but I will look and see when, if you want me to.

Q. No. As supervisor of the trust, or may I ask you, are you familiar with the declaration of trust that is involved in this proceeding?

(Testimony of Henry O. Wackerbarth.)

A. I glanced at it this morning. I haven't seen it since that lawsuit in 1947, up till this morning. I looked at a copy of it; that is correct.

Q. Do you know, or do you recall what Bob Smith's beneficial interest was in the trust?

A. Twelve and a half per cent, as I recall.

Q. Which was later increased?

A. And it would then have been increased [523] after——

Q. Mrs.——

A. ——Mrs. Charlotte Wood's death, his interest would have been increased; that is correct.

Q. Now, as a one-sixth beneficial owner, he was in control by virtue of being supervisor of the trust; is that correct? A. At a time, yes.

Q. Well, up till 1948?

A. Not at all times, no, because first Mr. Frank McGinnis was in charge of it, then Mr. Curtis Colyear was in charge of it; then after him Horace O. Smith, Jr., was in charge of it; that is correct.

Q. When he succeeded to the office of supervisor of the trust, that permitted him to absolutely control Schalk Chemical Company?

A. Permitted him to name three directors, which was the control of the board.

Q. And permitted him to vote all the shares?

A. That is correct.

Q. Now——

A. Well, he was—no. As I recall it, the trustee would give him a power of attorney to vote. I think that is the way it was.

(Testimony of Henry O. Wackerbarth.)

Q. Thank you. In your opinion, Mr. Wackerbarth, in the position of supervisor of the trust, was Mr. Smith [524] a trustee for his two sisters and his mother? A. Well, I think——

Q. In the management of this business?

A. I think anybody acting in that capacity is a trustee for all of the parties that he represents, and he didn't own the stock, all of the interest, so that he certainly was there representing somebody else, and the authority had been conferred upon him to do it by them.

Q. By whom?

A. By all of the parties that entered into the declaration of trust.

Q. Yes, but did the minor children approve it?

A. The guardian, their guardian approved it, yes.

Q. Mr. Colyear?

A. Yes, that is correct, because I took the petition into court for them, for them to court, to approve his entering into the trust on their behalf.

Q. But it still remains that he was acting in a fiduciary capacity when he was supervisor of the trust; isn't that correct? A. Who?

Q. Mr. Smith.

A. Well, I would say that he, any time a person represents a group, he is acting to their extent; to that extent, he is acting in the trust capacity, yes.

* * *

Received and filed August 4, 1958. [525]

[Title of Tax Court and Cause.]

Dockets Nos. 63853, 63855, 63862

ORDER ENLARGING TIME

For cause, it is

Ordered: That the time for filing the record on review and docketing the petition for review in the United States Court of Appeals for the Ninth Circuit is extended to January 17, 1960.

Dated: Washington, D. C., November 24, 1959.

/s/ J. E. MURDOCK,
Judge.

Served November 24, 1959.

[Title of Tax Court and Cause.]

T. C. Dockets Nos. 63853, 63855, 63862

CERTIFICATE

I, Howard P. Locke, Clerk of the Tax Court of the United States, do hereby certify that the documents submitted under this certificate, 1 to 41, inclusive, as called for by the designation, are the original documents of record on file in my office (excepting the original exhibits which are separately certified), and a true copy of the docket entries as they appear in the official docket of my office, in the

cases docketed at the above numbers in which the petitioners in this Court have filed petitions for review.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 20th day of November, 1959.

[Seal] /s/ HOWARD P. LOCKE,
Clerk of the Court.

[Endorsed]: No. 16702. United States Court of Appeals for the Ninth Circuit. Schalk Chemical Company, a corporation, Gerald I. Farman, Hazel I. Farman, John Carver Baker and Patricia Baker, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed and Docketed: December 8, 1959.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 16702

SCHALK CHEMICAL COMPANY, a California Corporation; GERALD I. FARMAN and HAZEL I. FARMAN, JOHN CARVER BAKER and PATRICIA BAKER,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS STATEMENT OF POINTS

To the Honorable Paul P. O'Brien, Clerk of the Above-Entitled Court:

In accordance with Rule 17(6) of the Rules of the above-entitled Court, petitioners state that the points on which they intend to rely are:

1. The Tax Court erred in holding that Schalk Chemical Company was not entitled to deduct the sum of $25,000 which it agreed to pay to Hazel I. Farman, Patricia Baker and Evelyn Marlow in reimbursement of the sum of $25,000 previously paid by them to Horace O. Smith, Jr.

2. The Tax Court erred in holding that the $25,000 was not paid to Horace O. Smith, Jr., by Hazel

I. Farman, Patricia Baker and Evelyn Marlow on behalf of Schalk Chemical Company and for its benefit and the preservation and protection of its business and reputation.

3. The Tax Court erred in holding that Schalk Chemical Company was not morally obligated to reimburse Hazel I. Farman, Patricia Baker and Evelyn Marlow for the $25,000 paid by them to Horace O. Smith, Jr.

4. The Tax Court erred in failing to hold that the $25,000 was paid to Horace O. Smith, Jr., by Hazel I. Farman, Patricia Baker and Evelyn Marlow as the majority owners of Schalk Chemical Company on its behalf and for its benefit and the preservation and protection of its business and reputation in order to free the Company from the absolute control which Horace O. Smith, Jr., a minority owner, had and exercised over the Company by virtue of extraordinary trust powers, in failing to hold that the majority owners had reasonable grounds for believing that removal of Horace O. Smith, Jr., and his management was imperative for the preservation and protection of the Company, and in failing to hold that in similar circumstances persons of ordinary prudence would have acted in similar fashion.

5. The Tax Court erred in holding that Schalk Chemical Company was not entitled to deduct in 1950 either as interest or as business expense the amount which it agreed to pay to Hazel I. Farman,

Patricia Baker and Evelyn Marlow as interest to compensate them for interest incurred by them in borrowing the $25,000 paid to Horace O. Smith, Jr.

6. The Tax Court erred in holding that the payment of $25,000 made by Schalk Chemical Company to Hazel I. Farman, Patricia Baker and Evelyn Marlow in 1951, constituted a dividend to Hazel I. Farman and Patricia Baker in that year to the extent that they participated in the payment.

7. The Tax Court erred in holding that the payment of $20,000 made by Schalk Chemical Company to Horace O. Smith, Jr., in 1951, in redemption of his one-sixth stock interest in the Company constituted a distribution essentially equivalent to a dividend to the remaining shareholders of the Company pro rata, including Hazel I. Farman and Patricia Baker.

8. The Tax Court erred in holding that the payment of $20,000 made by Schalk Chemical Company to Horace O. Smith, Jr., in 1951, in redemption of his one-sixth stock interest in the Company discharged a contractual obligation of the remaining shareholders.

9. The Tax Court erred in holding that Gerald I. Farman and Hazel I. Farman and John Carver Baker and Patricia Baker omitted from their gross income for the year 1951 an amount properly includible therein in excess of 25% of the amount of gross income reported in their returns.

10. The Tax Court erred in failing to hold that the assessment of deficiencies against Gerald I. Farman and Hazel I. Farman and John Carver Baker and Patricia Baker was barred under Section 275(a) of the Internal Revenue Code of 1939.

11. The Tax Court erred in ordering and deciding that, in the case of Schalk Chemical Company, there is a deficiency in income tax for the taxable year 1950 in the amount of $15,087.22; that, in the case of Gerald I. Farman and Hazel I. Farman, there is a deficiency in income tax for the taxable year 1951 in the amount of $11,589.98; and that, in the case of John Carver Baker and Patricia Baker, there is a deficiency in income tax for the taxable year 1951 in the amount of $2,465.86.

12. The Tax Court erred in that its opinion and decisions in this case are contrary to law and are not supported by the evidence of record.

December 14, 1959.

/s/ DONALD KEITH HALL,
Attorney for Petitioners.

[Endorsed]: Filed December 15, 1959.

[Title of Tax Court and Cause.]

No. 16,702

STIPULATION

It is hereby stipulated by and between the parties herein through their respective counsel that the exhibits admitted in the trial court proceeding in the above-entitled case be considered by the United States Court of Appeals for the Ninth Circuit in their original form as a part of the record herein without the necessity of printing these matters.

/s/ DONALD KEITH HALL,
Counsel for Petitioner.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Counsel for Respondent.

[Endorsed]: Filed January 13, 1960, U.S.C.A.

No. 16719

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SEARS, ROEBUCK & COMPANY, a corporation, *Appellant,* *vs.* SIDNEY SCHULEIN, Trustee in Bankruptcy of the Estate of Charles Robert Baldwin and Betty June Baldwin, bankrupts, *Appellee.*	No. 16719

Brief of Appellant

On Appeal from the United States District Court for the Eastern District of Washington Northern Division

JOHN HUNEKE
PAINE, LOWE, COFFIN, HERMAN & O'KELLY
of Spokane, Washington

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of Los Angeles, California
Attorneys for Appellant

C. W. HILL PRINTING CO.

No. 16719

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Attorneys for Appellant

A. SUBJECT INDEX

AUTHORITIES CITED

CASES

STATUTES

MISCELLANEOUS

B. STATEMENT OF JURISDICTION

This case arises out of a controversy in bankruptcy.

1. (a) The jurisdiction of the District Court is based on the following statutes:

52 Stat. 854; 11 USCA 46 — Jurisdiction of Bankruptcy Controversies.

62 Stat. 931: 28 USCA 1334 — District Court's Jurisdiction in Bankruptcy.

66 Stat. 420; 11 USCA 11 — Courts of Bankruptcy jurisdiction and powers.

(b) The jurisdiction of the Court of Appeals is based on the following statutes:

62 Stat. 929; 28 USCA 1291 — Jurisdiction of Appeals.

66 Stat. 423; 11 USCA 47 — Jurisdiction of Appellate Courts in Bankruptcy.

2. While the validity of the following section of the Bankruptcy Act is not questioned, its application in this case is the principal reason for the controversy which has arisen.

Sec. 70 (e) (2). 66 Stat. 429; 11 USCA 110 (e) (2).

"All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer and shall pass to, and every such transfer or obligation shall

be avoided by, the trustee for the benefit of the estate: *Provided, however,* That the court may on due notice order such transfer or obligation to be preserved for the benefit of the estate and in such event the trustee shall succeed to and may enforce the rights of such transferee or obligee. The trustee shall reclaim and recover such property or collect its value from and avoid such transfer or obligation against whoever may hold or have received it, except a person as to whom the transfer or obligation specified in paragraph (1) of this subdivision is valid under applicable Federal or State laws.

3. (a) The pleadings to sustain the jurisdiction in the District Court are found in the following references:

(1) Petition in Bankruptcy (Tr. 3)

(2) Order Affirming Order Declaring Conditional Sales Contract of Sears Roebuck and Co. Absolute Sale (Tr. 27)

Supplemental Order to Show Cause Why Conditional Sales Contracts Should not be Declared Absolute Sales and the Lien Thereof Preserved for the Benefit of the Bankrupt Estate. (Tr. 42)

(3) Certificate by Referee to Judge (Tr. 28)

Certificate by Referee to Judge (Tr. 38)

(b) The pleadings to sustain jurisdiction of the court of Appeals are found in the following references:

(1) Memorandum Decision and Order (Tr. 52-67)

(2) Notice of Appeal, Undertaking for Costs on Appeal and Appellant's Statement of Points. (Tr. 67, 68, 69).

Parenthetically, appellant respectfully points out that while the above cited Act covering jurisdiction of Appellate Courts in bankruptcy (66 Stat. 423, 11 USC 47) provides in part as follows:

> "and provided further that when any order, decree, or judgment involves less than $500.00, an appeal therefrom may be taken only upon allowance of the Appellate Court",

that this appeal does not refer to a money amount alone, but involves a principle and interpretation of the Bankruptcy Act which far transcends this particular case, and in many instances could exceed the $500.00 limitation. The Hon. Sam M. Driver, now deceased, in passing on this case and four somewhat similar cases, stated:

> "I have decided not to write a memorandum opinion for publication in Federal Supplement, as I think that in the public interest these cases — or at least one, or more, that are typical — should be appealed so that we may have an authoritative decision by the Court of Appeals for the Ninth Circuit. Since five of them have come up in the relatively small Eastern District of Washington within a short period of time, it seems logical to assume that a great number must arise in the Western District of this State, and in other large districts where the state statutory requirements are similar to those of Washington. In the event of appeal, any opinion that I might write, even if affirmance resulted, would be of very little authoritative value." (Tr. 57-58).

The parties to this appeal are conscientiously seeking a definitive answer for the guidance of trustees, adverse parties and the District Courts, in future dealings with this problem. Appellant respectfully suggests that the Court of Appeals

has jurisdiction. See *State of California v. Fred* S. *Renauld & Co.*, 179 F. 2d 605, wherein the Court stated at page 608,

> "In addition to the money herein involved it is apparent that the point for decision is of considerable importance to the state tax structure and of importance in relation to the federal bankruptcy act and its administration in the federal courts. We believe these circumstances justify our proceeding to consider the case on its merits."

C. QUESTION INVOLVED AND STATEMENT OF THE CASE.

The basic question in this case may be stated as follows:

Is a trustee in bankruptcy required to determine the true market value of personal property claimed as exempt by the bankrupt, and then to set aside such property to the bankrupt up to the valuation limits fixed by the state law; or does the fact that such property was purchased more than four months prior to bankruptcy under a conditional sale contract not filed for record in accordance with the state law, and on which a balance of the purchase price is still owing at the time of bankruptcy, permit the trustee to set aside to the bankrupt as exempt only a so-called "equity" in such personal property, and then proceed to collect the balance of the purchase price from the bankrupt?

The facts in this case are not in dispute and the controversy is one of interpretation based on the statutes and on the pleadings which point out the following sequence of events.

Charles Robert Baldwin and Betty June Baldwin, husband and wife, purchased from Sears Roebuck and Co., (hereinafter referred to as Sears, or as appellant) a sewing machine on December 18th, 1954, for $197.00, and a refrigerator on July 25th, 1955, for $211.95 under conditional sales contracts, which contracts were not recorded in accordance with the recording statutes of the State of Washington. (Tr. 18). RCW 63.12.010: Sale absolute unless contract filed; as follows:

> "All conditional sales of personal property, or leases thereof, containing a conditional right to purchase, where the property is placed in the possession of the vendee, shall be absolute as to all bona fide purchasers, pledgees, mortgagees, encumbrancers and subsequent creditors, whether or not such creditors have or claim a lien upon such property, unless within ten days after the taking of possession by the vendee, a memorandum of such sale, stating its terms and conditions, including the rate of interest and the purchase price exclusive of interest, insurance and all other charges, and signed by the vendor and vendee, shall be filed in the auditor's office of the county, wherein, at the date of the vendee's taking possession of the property, the vendee resides." (Balance not applicable.)

On February 21st, 1957, the Baldwins filed a voluntary petition in bankruptcy (Tr. 3-8) and were adjudicated bankrupt on February 25th, 1957 (Tr. 8), at which time there was still owing on the purchase price of the above two items of merchandise the sum of $231.72 (Tr. 14). The bankrupts claimed all of their household goods as exempt, estimating the value thereof at $320.00, but not limiting their claim to that amount. (Tr. 5, 7). Prior to any allowance of exemptions, the Trustee, by petition, obtained an order directed to Sears ordering it to show cause why any of its rights in

the above two items of household goods should not be transferred to the Trustee (Tr. 9-12). The attempt in seeking such order, and the result of the order appealed from, was to forfeit whatever rights Sears has in such property, and as such, Sears is an interested adverse party in the bankruptcy. Sears appeared in response to such order to protect its rights in the two items of merchandise mentioned above. Despite an order which was entered March 25th, 1957 (Tr. 13-14) the Referee re-opened the proceedings (Tr. 17) and allowed Sears to answer the Trustee's petition (Tr. 18-19). The Trustee on May 16th, 1957, filed a Report of Exempt Property to set apart the household furniture, with the following comment:

> ". . . Subject, however, to claim of lien of the Trustee arising out of . . . seller's interest in conditional sales contract of Sears-Roebuck RCW 6.16.010 et seq. 11 USCA Sec. 24 (Sec. 6 Bankruptcy Act) Equity to the extent of any excess over described liens." (Tr. 19-20)

Sears filed objections to the Report (Tr. 21-23). The Referee approved the Trustee's Report of Exemptions on May 27th, 1957, (Tr. 23, 24) and Sears petitioned for a review of both orders. The Referee certified the matter to the District Judge (Tr. 28-31). Thereafter the Hon. Sam M. Driver on February 28th, 1958, entered an order remanding the matter to the Referee for further action, which order is quoted in part as follows:

> "It is Now, Therefore, Ordered that this matter be remanded to the referee, who is hereby instructed to make or cause to be made a list of the items of property and the estimated values thereof claimed as exempt by the bankrupts, to set off such exemptions, or cause them

to be set off, if such has not heretofore properly been done, and specifically to find whether the property covered by the above referred to conditional sales contracts constitute a part thereof; that the referee give notice of his proposed findings and conclusions as aforesaid to the attorneys for the trustee, the bankrupt, and Sears, Roebuck and Company, giving them an opportunity to be heard and object thereto. After the determination of the exempt property, the referee shall reconsider the order hereinabove mentioned involved in this review proceeding, making such changes therein as he deems appropriate as a result of the findings made and conclusions reached pertaining to the exempt property, and that such order as the referee may then make, or cause to be made, shall be subject to review in the same manner as any other order entered by the referee." (Tr. 36-37).

The Trustee's amended Report on Exemptions (Tr. 40-42) listed the items of household goods set aside to the bankrupts, and referred to the two items being purchased from Sears as follows:

"Coldspot refrigerator—equity ..... 50.00* Value $200.00

Kenmore sewing machine —
equity ..... 35.00 Value $116.72

*These two items, at the time the petition was filed, were being purchased from Sears Roebuck & Co. under conditional sales contracts, the lien of which the trustee reserves the right to preserve for the benefit of the bankrupt estate."

This report having been approved (Tr. 37) and Supplemental Findings and Conclusions of Law having been entered, the Referee entered his Supplemental Order May 23rd, 1958, which is the basis for this appeal and which

Appellant submits is in error. It provides in part as follows:

> "It is Further Ordered, Adjudged and Decreed that all of the rights of said Sears Roebuck & Co. be and they are hereby preserved for the benefit of the bankrupt estate, and as a condition to retaining possession of said Kenmore sewing machine and Coldspot refrigerator the bankrupts shall pay to the trustee the unpaid balance owing thereon, to-wit, the sum of $231.72, in the same manner as is prescribed in the original contract of conditional sale." (Tr. 48).

From this order a petition for review was filed and after a hearing and argument the Hon. William J. Lindberg, District Judge, entered a Memorandum Decision and Order affirming the Referee's order explaining his decision in the following language.

> "It thus appears that the same basic questions now before me for review were before Judge Driver in the earlier review and an examination of his letter-opinion makes it clear that Judge Driver sustained and affirmed the referee on the issues here presented. Further, it is reasonable to assume from a reading of the latter portion of the letter-opinion that the motivating purpose of Judge Driver in remanding the case to the referee was to correct and remedy a defective record with respect to the trustee's report on exemptions so as to permit an appellate review of his decision on the basic question on the merits. Under the doctrine of 'law of the case' a judge of coordinate jurisdiction should not overrule decisions of his associate based on the same set of facts, unless required by higher authority or unless it can be authoritatively concluded that the earlier decision was clearly erroneous (Citing cases) I am not persuaded that Judge Driver's opinion is clearly erroneous and therefore it is incumbent upon me to affirm the order of the referee upon this review without going into the merits of the case." (Tr. 64-65).

This appeal followed.

The basic question set out above, further illuminated by these facts, now appears as follows:

Should the Trustee be required to set aside to the Baldwins the items of household goods, including the sewing machine and refrigerator, as exempt, as appellant contends; or may the Trustee set aside only the so-called "equity" of $85.00 in the sewing machine and refrigerator together with the other property, and then proceed to enforce collection of the balance of $231.72 due on the sewing machine and refrigerator from the Baldwins, as the Referee ordered?

The Washington exemption statutes allow as exempt, all wearing apparel, private libraries not to exceed $500.00 in value, household goods not exceeding $500.00 in value, and not to exceed $250.00 in lieu of animals (R.C.W. 6.16.020, Appendix i). Under these provisions the total property claimed by the bankrupt and listed in the Trustee's amended report of exemptions may be set aside within the allowable valuations. This includes the sewing machine and refrigerator.

The question may be even more simply stated. Under these circumstances may a Trustee in Bankruptcy set aside only an "equity" in personal property, wholly claimed as exempt, and then collect the balance of the purchase price of such goods from the bankrupt? The appellant's position is that the Trustee may not, and that the Referee and District Court are in error in so ordering.

D. SPECIFICATION OF ERRORS

The errors relied on are set out in appellant's Statement of Points as follows:

> "(1) The District Court erred in affirming the order of the referee in bankruptcy, declaring the unfiled conditional sales contracts covering the sale of a Coldspot refrigerator and a Kenmore sewing machine by Sears, Roebuck and Company to the bankrupts were absolute sales, when such items of personal property were claimed as exempt by the bankrupts.
>
> "(2) The District Court erred in affirming the order of the referee in bankruptcy that Sears, Roebuck and Company, Petitioners, had no further right, title, or interest, in the Coldspot refrigerator and Kenmore sewing machine purchased by the bankrupts under unfiled conditional sales contracts and claimed as exempt by the bankrupts.
>
> "(3) The District Court erred in affirming the order of the referee in bankruptcy that, as to the Coldspot refrigerator and Kenmore sewing machine purchased from Sears, Roebuck and Company under unfiled conditional sales contracts and claimed as exempt by the bankrupts, the interest of Sears, Roebuck and Company could be preserved by the Trustee for the benefit of the bankrupts' estate, and the two items could be retained by the bankrupts on condition that the balance of the sales contracts of Two Hundred and Thirty-One Dollars and Seventy-Two Cents ($231.72) be paid by the bankrupts into the bankrupts' estate." (Tr. 69-70)

As is apparent from the previous statements of the basic question involved, the errors referred to may be considered

together and the argument will be directed to the one issue in dispute.

E. SUMMARY OF ARGUMENT

Appellant's position is this. When household goods are claimed as exempt by bankrupts, and when such goods have a valuation within the state statutory exemptions, such goods must be set aside to the bankrupt, and the Trustee has no further right in such goods, nor any claim to any unpaid portion of the purchase price of such goods, and cannot collect or attempt to collect such unpaid purchase price from the bankrupt, despite the lack of filing of a conditional sale contract covering the original purchase of such goods.

Appellant's argument is divided into four subdivisions:

1. Title to exempt property at no time is in a bankruptcy Trustee.

2. Section 70 (e) (2) of the Bankruptcy Act does not purport to apply to exempt property.

3. The bankrupt's exemptions are not affected, in this case, by any interest Sears may have in the exempt property.

4. The Trustee cannot require the bankrupt to pay funds into the estate which are not subject to inclusion in the estate.

ARGUMENT

1. Title to exempt property at no time is in a bankruptcy Trustee.

It must be apparent, and yet it is the basic concept underlying Appellant's theory of this case, and should be kept in mind during the argument, that title to exempt property at no time is in the Trustee, but remains, at all times, in the bankrupt.

This has been true ever since *Lockwood v. Exchange Bank,* 190 US 294, 23 Sp. Ct. 751, 47 L.Ed. 1061, which involved bankruptcy and the claim of an unsecured creditor who held a waiver of exemptions by the bankrupt. The court held that as the entire property was within the exemptions allowed by state law, the bankruptcy court would not administer the exempt property and stated on page 300 of 190 U. S.

> ". . . Moreover, the want of power in the court of bankruptcy to administer exempt property is, besides, shown by the context of the act; since, throughout its text, exempt property is contrasted with property not exempt, the latter alone constituting assets of the bankrupt estate subject to administration . . ."

Also see *Baumbaugh v. Los Angeles Morris Plan Co.,* 30 F. 2d 816, involving the validity of a chattel mortgage given within four months prior to adjudication in bankruptcy. The following quotation from page 816 is in point:

> ". . . It was conceded by counsel for appellant on the hearing that the property covered by the chattel mortgage is, by the laws of California, exempt from execution. The title, therefore, did not pass to the

> trustee but remained in the bankrupt, and was not subject to administration by the bankruptcy court . . ."

Also see *In re Durham,* 104 F. 231 at 233:

> ". . . where the property is claimed as exempt, no title passes to the trustee, and he is only entitled to the possession thereof for the purpose of ascertaining, by proper appraisement, whether the value of the property does not exceed that allowed as exempt under the laws of the state . . ."

The bankrupt first must claim his exemptions, and the Baldwins did that in this instance. (Tr. 5, 7).

On Trustees, then, devolves the duty set out in Section 47 (a) (6) of the Bankruptcy Act to "set apart the bankrupt's exemptions allowed by law, as claimed, and report the items and estimated value thereof to the court as soon as practicable after their appointment."

General Order No. 17: 11 USCA foll. sec. 53.

In re Lippow, 92 F. 2d 619

Often this duty is ignored or postponed by Trustees, as it was in this case until required after appeal to the District Court. The Trustee made no itemization and no determination of value of such items until after the original appeal to the District Court. (Tr. 35-37).

When the exemptions are approved by the court, the property is then set aside to the bankrupt and the Trustee cannot administer it in any way, has no title to it, and no

concern over any claims which may exist between the bankrupt and some third party as to the exempt property.

In re Lippow, 92 F. 619 at 621:

> ". . . Title and possession of the goods in question passed to appellant, and the mere fact that certain creditors claimed superior rights does not preclude debtor from claiming such property as exempt. Remington on Bankruptcy, volume 3 (3d Ed. 1923) page 149, lays down the rule as follows: 'Nevertheless, the law is settled differently, and seems to be, in brief, that the sole question to be determined by the bankruptcy court is whether or not the property is exempt against creditors in general. If it be so exempt, then it is to be set apart, and further administration of it refused, notwithstanding that as to some creditors, it might not be exempt' . . ."

3 *Remington on Bankruptcy*, sec. 1271 at p. 143:

> ". . . Once property has been definitely set aside to the bankrupt as exempt, it is no longer within the control of the bankruptcy court, and ownership of the property as between the bankrupt and a third person is not subject to determination by that court . . ."

3 *Remington on Bankruptcy*, sec. 1286 at p. 177:

> ". . . Exemption claims of the bankrupt with respect to property which is exempt generally as to creditors are to be recognized and given effect by the court notwithstanding the property may not be exempt as to some creditors . . ."

3 *Remington on Bankruptcy*, sec. 1316 at p. 242:

> ". . . That there are creditors who have such favored claims is not a ground for refusing to allot and

deliver to the bankrupt property claimed as generally exempt . . ."

The items of exempt property, up to the valuation allowed by State statutes, being set aside to the bankrupt, neither add to nor detract from the estate that is subject to distribution to creditors. With such exempt property neither the creditors nor the Trustee are concerned.

An underlying purpose of the Bankruptcy Act is to make available to the creditors all of the bankrupt's property *except the exemptions.* To that end the various sections of the Act, including those with "strong-arm clauses," provide for seeking out and retaining for the estate all property in which the bankrupt had an interest, or which he may have concealed or transferred in fraud of creditors, but *over and above his exemptions.*

Likewise, all of each item of personal property claimed as exempt is set aside. There is no provision in the Washington State statutes for setting aside any partial interest in personal property. RCW 6.16.020 (Appendix i). The various items referred to in the statute are either set aside or they are not. In this case the bankrupt claimed as exempt his wearing apparel, a book, and his household furniture, including the sewing machine and refrigerator, all of which were belatedly itemized by the Trustee and which had a total valuation within the State of Washington statutes referred to above.

All wearing apparel is exempt and the Trustee valued this at $10.00 (Tr. 41). All private libraries up to $500.00 are exempt and the Trustee valued an encyclopedia at $10.00

(Tr. 41). Household furniture up to $500.00 is exempt and additional property may be selected up to a value of $250.00 in lieu of animals. The other items of household furniture including the refrigerator valued at $200.00 and the sewing machine at $116.72 would add up to a value set by the Trustee of $519.22 (Tr. 41) which is within the allowable exemptions for all of the items and their value. As such, these items of property must be set aside to the bankrupt and not administered further in the bankruptcy.

In re Kilgo, 223 F. 2d 167 at 170:

> ". . . It is well settled that when it becomes apparent the homestead property does not exceed the exemption, it is the duty of the Trustee to disclaim it as property of the bankrupt; and one holding a waiver, as here, may enforce his claim in the state court without regard to bankruptcy.

Also see *Baumbaugh v. Los Angeles Morris Plan Co.*, 30 F. 2d 816 (supra).

Appellant submits that as title to exempt property is never in the Trustee, as the items were claimed as exempt by the bankrupt, and as the valuation of such items set by the Trustee was within the statutory allowance, that all of the items, including the refrigerator and sewing machine must be set aside to the Baldwins without further administration in the bankrupt's estate.

2. Section 70 (e) (2) does not purport to apply to exempt property.

The Trustee in this case, and under the guise of this Section 70 (e) (2), is attempting to reach, or administer, an

interest in a portion of the exempt property, on the ground that the failure by Sears to file the original conditional sale contract in some way takes away some of the bankrupt's rights in the exempt personal property; and because this interest of Sears exists in the property, that in some fashion it should be added to the bankrupt's estate. To authorize this the Trustee relies on Section 70 (e) (2) of the Bankruptcy Act quoted above and particularly the 1952 Amendment, which added the proviso:

> "*Provided, however,* that the court may on due notice order such transfer or obligation to be preserved for the benefit of the estate and in such event the trustee shall succeed to and may enforce the rights of such transferee or obligee."

The Trustee then attempts to "preserve for the benefit of the estate" the interest that Sears has in the exempt property. Appellant submits that this is a mis-application of this section.

Appellant submits that the proviso is taken out of the context of Section 70 (e) by the Trustee and that this section applies only to transfers which are fradulent or voidable by any creditor having a provable claim, and does not purport to apply to exempt property. In situations involving other than exempt property, unless the Trustee is given the "strong arm" clause in the proviso quoted above, he would not be able to accomplish any benefit for the estate, in the sort of fradulent or voidable transfer referred to, by merely setting aside such fraudulent or void transfer; for the reason that then a junior encumbrancer, who otherwise would have no claim, could take advantage of the avoidance for his own benefit. The proviso was included

to prevent this windfall to a junior interest. That is not the situation in this case, as there is no "junior encumbrancer" who might otherwise gain an advantage over general creditors on the avoidance of a fraudulent or voidable transfer. Certainly the bankrupt is not such a junior encumbrancer, and there is no other.

The legislative history of this proviso seems to be limited to remarks contained in House Report No. 2320, 82nd Congress, 2nd Session (1952) at page 16, as follows:

> "Where under the act a transfer by way of lien, security title or otherwise, or an obligation, is void or voidable against a trustee in bankruptcy, it may under certain circumstances be necessary to preserve the same for the benefit of the estate by subrogating the trustee to the rights of the transferee or obligee, so that the benefits intended for the estate would not be passed on to junior interests not entitled thereto.
>
> "Under section 60b, the lien or security title, voidable as a preference, may be preserved for the benefit of the estate and passed to the trustee, and, under section 67a(3), a lien obtained by judicial proceedings, which is voidable, may likewise be preserved for the benefit of the estate and, to evidence title thereto, a conveyance thereof to the trustee may be directed. A like situation may arise under section 70e with respect to a transfer or obligation which is void or voidable against the trustee, but the subdivision contains no provision of preservation for the benefit of the estate similar to that contained in section 60b or section 67a(3). The bill provides language which supplies the omission and which is adapted to the situation." U. S. Code Congressional & Administrative News, Vol. 2, page 1976.

It is obvious that the proviso is added solely to give the Trustee the same "strong arm" provisions under this section that he had been given under the other sections mentioned. There is no inference, nor have any cases been found, that indicate that this section, 70(e), was meant to apply to exempt property. Section 70, in its entirety, covers "title to property". Section (a) provides that title of the bankrupt vests in the Trustee *"except insofar as it is property which is held to be exempt"*, and this quoted phrase is repeated twice later in the same section; (b) covers executory contracts; (c) gives Trustees benefit to defenses; (d) covers transfers after bankruptcy; (e) covers fraudulent or voidable transfers; (f) covers appraisals; (g) covers transfers to purchasers; (h) (repealed); and (i) covers arrangements. The entire section has to do with the *title* of the Trustee to property of the bankrupt, and does not apply to exempt property where title is not in the Trustee.

The purpose of this section is to preserve an asset for the "benefit of the estate" which might otherwise be lost and appellant submits that exempt property is not at any time considered as being for the benefit of the estate and no interest in exempt property can pass to the Trustee for the benefit of the estate.

To make this section, 70(e), applicable there must be in existence an actual creditor with a provable claim who can object to a fraudulent or voidable transfer. Appellant submits that there can be no such creditor in this case. There is nothing in the Washington State statute making the failure to file a conditional sales contract either fraudulent

or voidable. The statute only states that title is absolute as to all bona fide purchasers, subsequent creditors, etc.

The title becomes absolute and when claimed as exempt by the purchaser, there is no creditor to object. Sears is not a creditor as contemplated by the Section 70(e). Nor is the Trustee in bankruptcy such a creditor, and Section 70(e) does not apply in this case.

In Re Di Pierro, 159 F. Supp. 497 at 499:

> "(1) Under Section 70, sub. e of the Bankruptcy Act, the trustee in bankruptcy has the power to avoid any transfer which could have been avoided by any creditor of the debtor under applicable state or federal law had not bankruptcy intervened. The trustee does not possess an independent power of avoidance, but may act only upon the rights of at least one creditor having a provable claim in bankruptcy against whom the transfer or obligation was invalid under such law."

In Re Consorto Const. Co., 212 F. 2d 676 at 679:

> "Under this subdivision the trustee is subrogated to the rights of existing creditors as to whom the obligations of the bankrupt are voidable."

There can be no creditor then who could object to the rights of the Appellant, nor be entitled to any rights in the property when the property is claimed as exempt. Under these circumstances there is no person to qualify under Section 70(e) so that it is clearly evident that when the property is claimed as exempt, this section no longer has any application.

Under the Washington statutes, the title under unfiled conditional sale contracts is made absolute in the purchaser

as to actual creditors named in the statute. R.C.W. 63.12.010 (supra). If the title is absolute in the Baldwins, the exemption must be absolute also. It is obvious that if no exemption had been claimed in the property, the entire property, the title being absolute, would pass to the Trustee and there would be nothing in addition for the Trustee to preserve for the benefit of the estate. Also, there would be no interest of Sears to be considered. The Trustee would have the entire property and could sell or dispose of it for the benefit of the estate. However, when such property is claimed as exempt, the entire property is also exempt and there is no interest the Trustee can acquire in it.

The Trustee is not a bona fide purchaser, nor in the shoes of one, and even if he were, the claim of exemption would be good against him. The Trustee has complex rights, but the Trustee does not obtain greater rights under 70(e) than a creditor with a provable claim; and under the state law, no such creditor can complain if an exemption is claimed in the property. The Trustee is not executing on a judgment for the purchase price, and the purchaser can assert his exemption against everyone else.

See *Myers v. Matley,* 318 U.S. 622; 63 Sp. Ct. 780; 87 L. Ed. 1043 at 1044:

"An Adjudication in bankruptcy is not the equivalent of a judicial sale, nor is the trustee given the rights of a purchaser at such a sale."

Anderson Buick Co. v. Cook, 7 Wn. 2d 632, 110 P. 2d 857, at 638:

"In *Waddell v. Roberts,* 139 Wash. 273, 246 Pac. 755, we stated:

> 'An attaching creditor, or an execution creditor, levying upon and selling property as the property of his debtor, is not an innocent purchaser, or a *bona fide* purchaser for value. He takes in the property only such interest as his debtor has. (Citing cases.)' "

Also see *R. F. C. v. Hambright*, 16 Wn. 2d 81, 133 P. 2d 278

For that reason the Trustee is not in a position to complain, nor to apply this section, 70(e), to his situation.

The bankruptcy courts will leave to state courts any determination of a dispute involving property set aside as exempt, and any rights which the Appellant may claim in the exempt property. *In Re Nixon*, 34 F. 2d 667. Appellant submits that for these various reasons this section, 70(e) (2), does not apply to the situation involving exempt personal property.

3. The bankrupt's exemptions are not affected by any interest Sears may have in the exempt property.

Once the exempt property has been claimed by the bankrupt, has been valued by the Trustee, and set aside to the bankrupt by the court, the fact that a conditional sales vendor exists, who, as between the bankrupt and the vendor, may have certain rights, does not affect the bankrupt's estate nor the bankrupt's creditors in any way. *In Re Durham*, 104 Fed. 231 (supra).

A bankrupt may waive an exemption as against one creditor without making the exempt property subject to other bankruptcy creditors. *Lockwood v. Exchange Bank*, 190 U.S. 294; 23 Sp. Ct. 751; 47 L. Ed. 1061, (supra); *In*

Re Lippow, 92 F. 2d 619, (supra). This waiver may be by contract and the bankrupt may keep control of the property, and as such it is no concern of the Trustee and does not detract from the bankrupt's estate in any way, nor change the property available for distribution to creditors just because a vendor may still be in existence.

> 3 *Remington on Bankruptcy,* Sections 1313-1314, at page 239:
>
> ". . . Mere transfer of some interest in the property to another does not affect the bankrupt's right to claim it as exempt, particularly where he retains control."
>
> At page 240:
>
> ". . . Even if a discharge is granted, it cannot in any way impair a lien arising out of contract on exempt property or liens acquired thereon by legal proceedings more than 4 months before bankruptcy."

The fact that there may be a lien for the purchase price, which is ineffective except as between the parties, will not affect the bankrupt's exemption rights, nor does such constitute a transfer that may be voided in the bankruptcy by the Trustee.

3 Remington on Bankruptcy, (supra)

Baumbaugh v. Los Angeles Morris Plan Co., 30 F. 2d 816 (supra)

In re Nixon, 34 F. 2d 667 (supra)

In re Consorto Const. Co., 212 F. 2d 676 (supra)

4. The Trustee cannot require the bankrupt to pay funds into the estate which are not subject to inclusion in the estate.

It seems obvious again to appellant that the bankrupt's estate consists of that property existing at the time of the bankruptcy. Whatever property he has, whatever interests there are, are fixed as of that date, and there is no provision in the Act compelling the bankrupt to pay into the estate any after acquired funds.

11 U.S.C.A., Sec. 110, Notes 781-820

Hudson v. Wylie, 242 F. 2d 435 at 444

> ". . . It is said by the court that it is one of the salutary policies of the Bankruptcy Act that one's wages earned after adjudication belong to him and not to his trustee. To hold otherwise, said the court, would be to put the bankrupt into a type of involuntary bondage."

To do so would defeat the purpose of the bankruptcy law. The position taken by the Trustee in this case can only be sustained by requiring the bankrupt to pay such after acquired funds into the estate.

The order entered from which this appeal is taken, places a condition on the bankrupt's retaining the exempt property, and that is that the bankrupt pay into the estate the balance of the purchase price. (Tr. 48, 67). The Trustee states that he is merely "preserving a lien of the appellant for the benefit of the estate", but the only way that it can be preserved is to require the bankrupt to pay in money which he must acquire subsequent to bankruptcy. The only alter-

native to the condition imposed by the order is to forfeit the exemptions. The only way the bankrupt can keep his exemptions under this order, the only way he can keep the sewing machine and the refrigerator, would be to pay into the estate $231.72 out of after-acquired funds. There is no other way the lien can be "preserved for the benefit of the estate". This should point out the error of the Trustee's position. Without a claim of exemption the property is in the bankrupt's estate. If the bankrupt claims this exemption the same result is achieved under the Trustee's theory, unless the bankrupt can be compelled to pay into the estate after acquired funds. This is nothing more than requiring the bankrupt to buy his exemptions. There is nothing in the spirit or wording of the Bankruptcy Act that requires such action.

This error is also apparent from the illogical basis on which the Trustee arrives at the "equity" he attempts to set aside to the bankrupt.

He has arbitrarily arrived at a so-called "equity" which is valued at $85.00. (Tr. 41). This figure was obviously arrived at by deducting the balance of the purchase price of $231.72 from the market valuation of the two items, found to be the sum of $316.72. Appellant submits that there is no accepted definition of "equity" and the Trustee's manner of arriving at such a figure is not logical. Suffice it to point out that property, rapidly depreciable, may reach a market value at a given date, equal to or even below the balance then due on the purchase price. If the purchaser at that time has paid in, as an example, one-half of the purchase price, he should have some "equity" in the property. But under

the Trustee's formula it would appear that the purchaser had no "equity" at all in the property. Subtracting the balance due from the then market value, leaves zero. It seems more logical to assume that if a purchaser had paid in one-half the purchase price, his equity should be one-half the value, disregarding the balance of the purchase price. An "equity" in property should be the pro-rate portion of the purchase price paid to the then market value. If an "equity" is to be set aside as exempt, this would result in setting aside an "equity" of one-half the market value with the Trustee then attempting, under his interpretation of the Act, to enforce the full balance of the purchase price which would include a portion of an exempt "equity" already set aside. This, the Trustee obviously cannot do. He cannot enforce a lien against exempt property, and this points out again, the fallacy of the Trustee's position and the error in arbitrarily arriving at an "equity" figure, which is not covered in the Bankruptcy Act and is not a logical basis for such assumption.

Appellant submits that as the order appealed from requires the bankrupt to pay into his estate after-acquired funds, as a condition to keeping his exemptions, it is obviously in error. As it is also apparent that the only way this so-called "lien" of Sears can be "preserved for the benefit of the estate" is to require the bankrupt to pay in such funds, that the error of the Trustee's position should be obvious.

CONCLUSION

Appellant, Sears, respectfully submits that as the Baldwins claimed their household goods as exempt, and as these items were within the allowable valuations under state law, that title did not ever vest in the Trustee, and these items should be set aside as exempt to the Baldwins free and clear of any lien in the Trustee. Appellant submits that the interest of Sears in such property in no way affects such exemptions, and that it does not give the Trustee power under 70 (e) (2) to preserve such "lien" for the benefit of the estate, for the double reason that 70 (e) (2) does not apply to exempt property, and the Trustee cannot require the bankrupt to pay after-acquired funds into the estate as a condition to keeping his exempt property. Any other conclusion is contrary to the purpose of the Bankruptcy Act. Appellant submits that the order appealed from is in error and that the order should be reversed and the Referee should be ordered to set apart to the Baldwins the refrigerator and the sewing machine as exempt, free and clear of any claim by the Trustee.

Respectfully submitted,

JOHN HUNEKE
PAINE, LOWE, COFFIN, HERMAN
& O'KELLY

THEODORE G. MORRIS
WHEELER, McCUE & MORRIS
Attorneys for Appellant.

RCW 6.16.020 — Exempt property specified. The following property shall be exempt from execution and attachment, except as hereinafter specially provided:

(1) All wearing apparel of every person and family.

(2) All private libraries not to exceed five hundred dollars in value, and all family pictures and keepsakes.

(3) To each householder one bed and bedding and one additional bed and bedding for each additional member of the family, and other household goods and utensils and furniture not exceeding five hundred dollars coin in value. The other household goods and utensils and furniture specified above, shall, on the demand of the officer having the execution or attachment in hand, be selected by the husband, if present, if not present they shall be selected by his wife, and in case neither husband or wife, nor other person entitled to the exemption by having the description of a householder, shall be present to make the selection, then the sheriff shall make a selection of the household goods, utensils and furniture equal in value to said five hundred dollars and shall return the same as exempt by inventory, and such selection by the sheriff or other person described above shall be prima facie evidence: (a) That such household goods, utensils and furniture are exempt from execution and attachment, (b) that the value of the property so selected is not over five hundred dollars.

(4) To each householder two cows, with their calves, five swine, two stands of bees, thirty-six domestic fowls, and provisions and fuel for the comfortable maintenance of such householder and family for six months, also feed for such animals for six months: Provided, That in case such householder shall not possess or shall not desire to retain the animals named above, *he may select from his*

property and retain other property not to exceed two hundred and fifty dollars coin in value. (emphasis supplied) The selection in the proviso mentioned, shall be made in the manner, and by the person and at the time mentioned in subdivision (3), and said selection shall have the same effect as selections made under subdivision (3), of this section.

(5) through (13) (not applicable.)

(14) A sufficient quantity of hay, grain or feed to keep the animals mentioned in the several subdivisions of this chapter, for six weeks. *But no property shall be exempt from an execution issued upon a judgment for the price thereof, or any part of the price thereof,* (emphasis supplied) or for any tax levied thereon.

IN THE

UNITED STATES

Court of Appeals

FOR THE NINTH CIRCUIT

SEARS ROEBUCK & COMPANY,
a corporation,
Appellant,

vs.

SIDNEY SCHULEIN, Trustee in Bankruptcy of the Estate of Charles Robert Baldwin and Betty June Baldwin, bankrupts,
Appellee

No. 16719

BRIEF OF APPELLEE

On Appeal from the United States District Court for the Eastern District of Washington, Northern Division

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A. SUBJECT INDEX

AUTHORITIES CITED

CASES

STATUTES

B. APPELLANT'S STATEMENT OF JURISDICTION AND STATEMENT OF CASE

Appellee accepts the jurisdictional statement of the appellant, together with its statement of the case.

C. ARGUMENT

D. ANSWER TO SPECIFICATIONS OF ERROR

The three specifications of error made are so intertwined and interdependent that it becomes impossible to discuss them separately.

This is not an attempt by a trustee in bankruptcy to wrest from the bankrupt property which might be exempt to him. It is merely the exercising of his right to avoid a security transaction. Sec. 63.12.010, Revised Code of Washington (set forth at page 5 of appellant's brief) recognizes the validity of an unfiled conditional sales contract as between vendor and vendee. It says, however, that the sale shall be absolute as to the rights of subsequent creditors.

If the bankrupt had not filed his petition in bankruptcy, title to the property sold would have remained in appellant as security for the payment of the purchase price. There would have been no exemption available to him to the extent of the unpaid balance of the purchase price.

E. ANSWER TO ARGUMENT OF APPELLANT

1. Answer to contention that "title to exempt property at no time is in a bankruptcy trustee".

We are utterly unable to see the significance of this statement. First of all, it is not the exempt property which is sought by the trustee. Instead, the distinction which appellant fails to make is that in this case the trustee is merely seeking to avail himself of the rights of a subsequent creditor and to preserve the voidable lien for the benefit of all creditors. Moreover, the property in question was not exempt to the bankrupt as between the bankrupt and appellant as vendor. If the trustee had not challenged the contract of sale, appellant would have remained in a favored position, with retention of title and the right either to repossess or collect the balance of the purchase price. In the present case the rights of the bankrupt for whose benefit the exemption laws were enacted are not affected or disturbed. The only change made is that the trustee now stands in the position of the vendor.

2. Answer to contention that Sec. 70(e)(2) does not purport to apply to exempt property.

Again we reiterate the proposition that this was a proceeding to preserve the benefits of a security transaction for the trustee. Since title to the property was reserved in the appellant vendor until payment of the purchase price, the property in question had not risen to the dignity of property of the bankrupt. As between vendor and vendee, the rights were solely in the vendor.

We draw to the Court's attention the provisions of

Section 6 of the Bankruptcy Act (11 U.S.C.A. §24) which provides:

> "This Act shall not affect the allowance to bankrupts of the exemptions which are prescribed by the laws of the United States or by the State laws in force at the time of the filing of the petition in the State wherein they have had their domicile for the six months immediately preceding the filing of the petition, or for a longer portion of such six months than in any other State: *Provided, however, That no such allowance shall be made out of the property* which a bankrupt transferred or concealed and which is recovered or *the transfer of which is avoided under this Act for the benefit of the estate, except that where the voided transfer was made by way of security only and the property recovered is in excess of the amount secured thereby, such allowance may be made out of such excess.*" (Italics ours)

This provision was followed in the present case. The bankrupt was allowed as exempt the value of the property in excess of the voided transfer. It would be hard to express in any clear language and intendment that a security transaction such as this could be avoided.

> "A debtor cannot claim an exemption as against an obligation representing the purchase price of the property claimed exempt."—*In re Phillips*, 209 Fed. 490.
>
> "An unfiled conditional seller has no standing to complain of the failure of the trustee to set aside exemptions."—*Sears-Roebuck & Co. v. McAllister* (9th Cir.), 184 F. (2d) 487. (Refers to *Lockwood v. Ex. Bank,* 190 U.S. 294 (1902)).

This is the concern of the bankrupt and not that of the creditors.

It should be borne in mind that under the laws of the State of Washington pertaining to exemptions, household goods are not per se exempt. They must qualify for exemption (the exemption in this case being a limit of $500), and the particular property must be claimed as exempt. The exemption laws are not self-executing. Sec. 6.16.080; 6.16.090, Rev. Code of Washington.

What the bankrupt acquires as exempt is his "equity" over and above the previously existing lien or, as Section 6 of the Bankruptcy Act states, "such excess".—*Hemsell v. Raab* (5th Cir.), 29 F. (2d) 194; *In re Porter,* 3 Fed. Supp. 582.

3. Answer to contention that "the bankrupt's exemptions are not affected by any interest Sears may have in the exempt property."

We have no quarrel with this general statement, which only serves to point up the proposition that the bankrupt's exemptions are not affected by the transferring of the appellant's rights to the trustee.

4. Answer to contention that "The trustee cannot require the bankrupt to pay funds into the estate which are not subject to inclusion in the estate".

We believe that this argument is immaterial. Obviously the trustee cannot and will not compel the bankrupt to pay funds into the estate but the trustee will insist that the bankrupt either pay the balance of the purchase price owing or resort to the right of repossession under the contract of sale.

F. ADDITIONAL ARGUMENT IN SUPPORT OF JUDGMENT

As we have mentioned before, the exemption laws of the State of Washington are not self-executing. Until a claim is made by a debtor and a determination is made, there can be no exemption. In the present case the trustee designated as exempt only the "equity" of the bankrupts in the property being purchased from appellant, and it was that interest, and only that interest, which was ultimately set aside to the bankrupts as exempt. Although a complaint had been made of the original designation of exempt property (Tr. 21), when the amended report of exemptions was filed (Tr. 40) it was approved by the Referee. And no complaint has been made on that award. We therefore have a situation where appellant's whole theory that the trustee is attempting to take over exempt property collapses.

The language used by the District Judge in *In Re Mattingly,* 42 Fed. Supp. 608, relative to the purpose of exemption laws and their effect in situations such as we find in this case is persuasive. In that case the court said:

> "Exemption laws are simply for the benefit of the debtor and not for the purpose of enabling some creditor to secure for himself a larger percentage of the debtor's estate than is secured by other general creditors. In the present case the petitioning creditors are only general creditors in that they failed to record their conditional sale contract, which is required by the Kentucky law in order to give them a

lien against the property superior to other creditors (citing cases). They could have been secured creditors if they had so desired, but for reasons sufficient unto themselves they evidently preferred not to record their mortgage. I see no principle of equity which would require that after having intentionally abandoned their position as secured creditors for reasons of their choosing, they be now restored to that position to the prejudice of other general creditors."

CONCLUSION

It is respectfully submitted that the order heretofore entered should be affirmed.

Respectfully submitted,

THOMAS MALOTT

Attorney for Sidney Schulein,

Trustee in Bankruptcy

No. 16719

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

SEARS, ROEBUCK & COMPANY, a corporation, *Appellant,* *vs.* SIDNEY SCHULEIN, Trustee in Bankruptcy of the Estate of Charles Robert Baldwin and Betty June Baldwin, bankrupts, *Appellee.*	No. 16719

Appellant's Reply Brief

On Appeal from the United States District Court for the Eastern District of Washington Northern Division

JOHN HUNEKE
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No. 16719

IN THE

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SEARS, ROEBUCK & COMPANY, a corporation, *Appellant,*	
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THEODORE G. MORRIS
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of Los Angeles, California
Attorneys for Appellant

CASES CITED

ARGUMENT

In the interest of clarifying the arguments presented on behalf of both parties, Appellant respectfully submits the following comments in reply to the brief of Appellee.

The Appellee's brief is built on mis-emphasis of principles and unwarranted inferences drawn therefrom. These will be briefly referred to in the sequence of their appearance:

1. On page 1 of Appellee's brief the statement in the last paragraph under D, covering the situation if *no* bankruptcy has been filed, is misleading. Contrary to the Appellee's statement, title to the personal property would not have remained in Appellant, but, as to all subsequent creditors, would be in the Baldwins; and the Baldwins would have an exemption available to them and could claim such exemption against everybody except Sears. The filing of bankruptcy works no change, and the Baldwins have title and can claim an exemption as against the trustee, and retain title to the property as against the trustee.

2. The argument under E. 1 on page 2 of Appellee's brief ignores the established and recognized authority of *Lockwood v. Exchange Bank*, 190 U. S. 294, 23 Sup. Ct. 751, 47 L.Ed. 1061, cited in Appellant's opening brief; wherein it was pointed out that in bankruptcy the presence of an interest such as Sears has in this case, does not prevent a claim of exemption by bankrupts in the property. Contrary to Appellee's statement, the trustee here is seeking exempt property, but the property is exempt insofar as

the trustee is concerned, and the trustee cannot succeed to title to such exempt property.

3. Under argument No. E. 2 on page 2 of Appellee's brief, if title to the property was actually reserved in Sears, as Appellee states, then the trustee would have no rights in it whatsoever. The Washington conditional sales statutes place title in the Baldwins, and the trustee may succeed to such property, unless it is claimed as exempt, in which case the title remains in the Baldwins, it does not remain in Sears so far as the trustee is concerned.

4. The Appellee cites Section 6 of the Bankruptcy Act on page 3 of its brief, but there is in this case no attempted avoidance "under this Act." The trustee is only attempting to acquire a right under a state statute. This he cannot do. See *Rosof v. Roth*, 169 Fed. Supp. 707 at page 712. The Appellee's argument begs the question of whether the transaction is voidable. There is nothing being avoided, the trustee is merely attempting to preserve a lien which he claims is voidable. This is not such a situation as Section 6 refers to or contemplates.

5. *In re Phillips,* cited on page 3 of Appellee's brief, is authority for the Washington state statute, which provides that a debtor cannot claim exemption against an execution on an obligation representing a part of the purchase price, but this, of course, does not prevent the Baldwins from claiming an exemption against every other situation, including the trustee in bankruptcy. There then seems to be no particular reason to cite this case.

6. Appellee has included in page 3 what appears to be a quotation from *Sears Roebuck and Company v. McAllister*, 184 F. (2d) 487, with which short opinion this court must be thoroughly familiar. We have been unable to find the cited quotation in the published opinion, and submit that the McAllister case is not authority for the statement quoted, which must have been credited to it inadvertently by Appellee. Similarly *Lockwood v. Exchange Bank* does not support the statement either, despite the reference to it in the same citation.

7. Appellee next states under his argument No. 2 on page 4 that the Washington exemption laws are not self-executing, with what inference or purpose Appellant does not understand. In this case the Baldwins *did* claim the property as exempt. They can do no more. The Washington statutes, as quoted in the opening brief, allow setting aside a valuation of $750.00 and the trustee's duty is to set aside claimed property up to that valuation.

8. Appellant submits that the *Hemsell v. Rabb* and *In re Porter* cases cited on page 4 of Appellee's brief do not set out any rule contrary to the *Lockwood v. Exchange Bank* decision, and do not alter the principle set out therein. Each of the two cited cases was based on a homestead exemption made subordinate by state law to pre-existing liens declared voidable under Section 67 of the Bankruptcy Act. We do not have that situation in this case.

9. Appellee's argument No. E. 3 on page 4 makes no attempt to answer Appellant's opening argument, but only mis-emphasizes it to come within the Appellee's conclusion

that bankrupt's exemptions are not affected by a transfer to the trustee. The trustee clearly is attempting to ignore the bankrupt's exemptions and divert them to his own purpose.

10. Appellee's argument No. E. 4 on page 4 is obviously inconsistent. The court order appealed from requires the Baldwins to pay the balance of the purchase price to the trustee. Appellee states the trustee "will not" compel the payment, but then states that the trustee "will insist" that this be done. Appellant submits that even under the theory of preserving a lien by the trustee, there is no authority for transferring a contract right of "resorting to repossession" to him.

11. Under Appellee's "Additional Argument in Support of Judgment" F on page 5, it need only be pointed out again that the Baldwins did claim their exemptions. They made no claim for an "equity" only. They claimed the entire property. It was the trustee who attempted to set aside an "equity" and from the referee's decision approving that result, the appeal was taken.

12. The Appellee's brief is brought to a close by reliance on the case of *In re Mattingly*, cited on page 5, and a citation thereform. This case is distinguishable on the facts in that certain creditors there sought to have the bankrupt forced to claim an exemption. Here the Baldwins claimed their exemption. Sears abides by and relies on that action of the bankrupts. Further, the quoted portion of the Mattingly case is dictum only. That case was in a District Court in the Sixth Circuit. We are here in the Ninth Circuit where the case of *Baumbaugh v. Los Angeles Morris Plan Co.*, 30 F.

(2d) 816, cited in Appellant's opening brief, has been decided, and we assume is still the law. This court in that case said the bankrupt could not waive exemptions, which had once been claimed, to the detriment of a creditor having a special lien claim against it. Under the present state of the decisions, Appellant submits that the *Morris Plan* case is controlling, not the *Mattingly* dictum.

Reaffirmation of Appellant's Principles.

When the chaff is all blown away, the essential kernels must be apparent. The Baldwins claimed the refrigerator and sewing machine as exempt. The value of these items, together with the value of all the property claimed exempt by the Baldwins, was within the state valuation limits, and must be set aside to the Baldwins without any title or portion thereof going to the trustee.

The trustee, Appellee, under the wording of Section 70(e)(2) of the Bankruptcy Act, is attempting to apply the wording of the 1952 Amendment to a situation it was not intended to meet.

The trustee is not in a position to step into the shoes of Sears in this case. There is no basis in the Bankruptcy Act under which he can claim to do so. There are no rights he can claim in exempt property.

In a similar case in the Western District of Washington, Northern Division, United States District Judge, The Hon. William J. Lindberg, passed on this exact point in the attempted application of Section 70(e)(2) by a bankruptcy

trustee to a similar situation. That was the case of *In re Espelund*, Bankruptcy No. 44906 in such court, in which the following is cited from the Judge's opinion dated June 30th, 1959:

> "The question then is whether Congress intended, by virtue of the 1952 Amendment (70(e)(2)) to make said sub-division effective with respect to exempt property . . ."
>
> "Nothing in said report indicates an intent on the part of Congress to give meaning to Section 70(e)(2) by virtue of the Amendment which would expand the rights of creditors through the trustee to the exempt property of the bankrupt."
>
> "If in the case at bar, the property had not been exempt, title would have passed to the trustee . . . If, in addition however, there had been a junior encumbrancer whose lien was not voidable as to the trustee, there would be occasion for the preservation.
>
> "Providing for such preservation is all that the 1952 Amendment to 70(e)(2) appears to do. To hold that this Amendment has the sudden and drastic effect of bringing exempt property into the operation of the Act does too much violence to the balance of Section 70 which must be read as a whole, as well as Section 6 of the Bankruptcy Act.
>
> "It is therefore my opinion that the order of the referee under date of December 2nd, 1958, so far as it voids the lien of petitioner, Pacific Finance Company, obtained by a chattel mortgage dated April 28th, 1958, upon household goods belonging to the bankrupt as to the trustee, and preserves it for the benefit of the estate, is invalid and must be reversed."

It must be apparent that the order in this case is very similar to the one reversed by Judge Lindberg. If we were to allow the trustee to carry out the terms of the order entered below in this case, it would force the Baldwins, as a condition to retaining their exempt property, to pay to the trustee after acquired funds, money not subject to bankruptcy. The *Lockwood* and *Morris* cases cannot be so lightly and easily ignored. The protection given exemptions by the Bankruptcy Act cannot be so readily flaunted. The bankrupt is entitled to his exemptions. The trustee is not. Appellant resubmits that the order appealed from should be reversed.

Respectfully submitted,

John Huneke
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& O'KELLY

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Attorneys for Appellant.

No. 16719

United States
Court of Appeals
for the Ninth Circuit

SEARS, ROEBUCK & COMPANY, a corporation,
Appellant,

vs.

SIDNEY SCHULEIN, Trustee in Bankruptcy of the Estate of Charles Robert Baldwin and Betty June Baldwin, bankrupts,
Appellee.

Transcript of Record

Appeal from the United States District Court for the Eastern District of Washington, Northern Division

Phillips & Van Orden Co., Fourth and Berry Sts., San Francisco, Calif.—2-9-60

No. 16719

United States
Court of Appeals
for the Ninth Circuit

SEARS, ROEBUCK & COMPANY, a corporation,
Appellant,

vs.

SIDNEY SCHULEIN, Trustee in Bankruptcy of the Estate of Charles Robert Baldwin and Betty June Baldwin, bankrupts, Appellee.

Transcript of Record

Appeal from the United States District Court for the Eastern District of Washington, Northern Division

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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In the United States District Court, Eastern District of Washington, Northern Division

In Bankruptcy No. B-10851

In the Matter of

CHARLES ROBERT BALDWIN and BETTY JUNE BALDWIN, husband and wife,

Bankrupt.

DEBTOR'S PETITION

To the Honorable Samuel L. Driver, Judge of the United States District Court for the Eastern District of Washington.

The Petition of Charles Robert Baldwin and Betty June Baldwin, husband and wife, individually and the community composed of them, residing at No. 6704 East 7th Avenue in Dishman, County of Spokane, State of Washington, by occupation a Floor Installer and employed by [or engaged in the business of] Brown Trailers, Inc., who states that he has not been known by any other name or trade name, for the past six years, other than .....,

Respectfully Represents:

1. Your petioner has had his principal place of business [or has resided, or has had his domicile] at Dishman, Washington, within the above judicial district, for a longer portion of the six months immediately preceding the filing of this petition than in any other judicial district.

2. Your petitioner owes debts and is willing to surrender all his property for the benefit of his

creditors, except such as is exempt by law, and desires to obtain the benefit of the Act of Congress relating to bankruptcy.

3. The schedule hereto annexed, marked Schedule A, and verified by your petitioner's oath, contains a full and true statement of all his debts, and, so far as it is possible to ascertain, the names and places of residence of his creditors, and such further statement concerning said debts as are required by the provisions of said Act.

4. The schedule hereto annexed, marked Schedule B, and verified by your petitioner's oath, contains an accurate inventory of all his property, real and personal, and such further statements concerning said property as are required by the provisions of said Act.

Wherefore Your Petitioner Prays, That he may be adjudged by the court to be a bankrupt within the purview of said Act.

/s/ CHARLES ROBERT
BALDWIN,
/s/ BETTY JUNE BALDWIN.

/s/ JOSEPH L. McDOLE,
Attorney for Petitioner.

United States of America,
State of Washington,
County of Spokane—ss.

We, Charles Robert Baldwin and Betty June Baldwin, husband and wife, the petitioner named in

the foregoing petition, do hereby make solemn oath that the statements contained therein are true according to the best of my knowledge, information, and belief.

/s/ CHARLES ROBERT BALDWIN,

/s/ BETTY JUNE BALDWIN, Petitioner.

Subscribed and sworn to before me this 20th day of February, 1957.

[Seal] /s/ JOSEPH L. McDOLE, Notary Public in and for the State of Washington, residing at Spokane. [1]*

Schedule B-5. Property Claimed as Exempt From the Operation of the Act of Congress Relating to Bankruptcy.

[N.B.—Each item of property must be stated, with its valuation, and, if any portion of it is real estate, its location, description and present use.]

Property claimed to be exempt by the laws of the United States, with reference to the statute creating the exemption: Household furniture—furnishings, personal clothing in schedule B-2 (D) and New Standard Encyclopedia. The above named property

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* Page numbers appearing at bottom of page of Original Transcript of Record.

claimed to be exempt in accordance with the provisions of the Laws of the State of Washington, R.C.W. 6.16.010 et seq. Valuation: $320.00.

Property claimed to be exempt by State laws, with reference to the statute creating the exemption: Lot Nineteen (19) Block Twenty (20) of Empire Addition to the County of Spokane, State of Washington. The above named property claimed to be exempt in accordance with the provisions of the Laws of the State of Washington. R.C.W. 6.12.010 et seq. Valuation: $180.00.

Total, $500.00.

/s/ CHARLES ROBERT BALDWIN,
/s/ BETTY JUNE BALDWIN,
Petitioner. [2]

Summary of Debts and Assets

[From the statements of the debtor in Schedules A and B.]

Schedule A—1-a Wages, None: None.

Schedule A—1-b (1) Taxes due United States, None: None.

Schedule A—1-b (2) Taxes due States, None: None.

Schedule A—1-b (3) Taxes due counties, districts and municipalities, None: None.

Schedule A—1-c (1) Debts due any person, including the United States, having priority by laws of the United States, None: None.

Schedule A—1-c (2) Rent having priority, None: None.

Schedule A—2 Secured claims: 1859.20.

Schedule A—3 Unsecured claims: 428.95.

Schedule A—4 Notes and bills which ought to be paid by other parties thereto: None.

Schedule A—5 Accommodation paper: None.

Schedule A, Total: 2288.15.

Schedule B—1 Real Estate: 180.00.

Schedule B—2-a Cash on hand, None: None.

Schedule B—2-b Negotiable and non-negotiable instruments and securities, no: None.

Schedule B—2-c Stock in trade, None: None.

Schedule B—2-d Household goods: 300.00.

Schedule B—2-e Books, prints, and pictures: 20.00.

Schedule B—2-f Horses, cows, and other animals, None: None.

Schedule B—2-g Automobiles and other vehicles, None: None.

Schedule B—2-h Farming stock and implements, None: None.

Schedule B—2-i Shipping and shares in vessels, None: None.

Schedule B—2-j Machinery, fixtures, and tools, None: None.

Schedule B—2-k Patents, copyrights, and trademarks, None: None.

Schedule B—2-l Other personal property, None: None.

Schedule B—3-a Debts due on open accounts, None: None.

Schedule B—3-b Policies of insurance, None: None.

Schedule B—3-c Unliquidated Claims, None: None.

Schedule B—3-d Deposits of money in banks and elsewhere, None: None.

Schedule B—4 Property in reversion, remainder, expectancy or trust, no: None.

Schedule B—5 Property claimed as exempt, $500.00.

Schedule B—6 Books, deeds and papers: None.

Schedule B, Total: 500.00.

/s/ CHARLES ROBERT
BALDWIN,
/s/ BETTY JUNE BALDWIN,
Petitioner. [3]

[Endorsed]: Filed February 21, 1957.

[Title of District Court and Cause.]

ADJUDICATION OF BANKRUPTCY

At Spokane, Washington, in said District, on the 25th day of February, 1957.

The petition of Charles Robert Baldwin and Betty June Baldwin, husband and wife, filed on the 21st day of February, 1957, that Charles Robert Baldwin and Betty June Baldwin, husband and wife, be adjudged bankrupt under the Act of Con-

gress relating to bankruptcy, having been heard and duly considered; and there being no opposing interest;

It is adjudged that the said Charles Robert Baldwin and Betty June Baldwin, husband and wife, are bankrupt under the Act of Congress relating to bankruptcy.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [4]

[Endorsed]: Filed February 25, 1957.

[Title of District Court and Cause.]

PETITION TO DECLARE CONTRACT OF CONDITIONAL SALE TO BE ABSOLUTE SALE

The undersigned trustee in bankruptcy of the estate of the above named bankrupt petitions and represents:

I.

The word "bankrupt," as used herein, denotes the individual bankrupt or all bankrupts named in the above proceeding, if there be more than one.

II.

That your petitioner is the duly appointed, qualified and acting trustee in bankruptcy of the estate of the above named bankrupt.

III.

By virtue of a voluntary petition in bankruptcy filed by him in the above Court on February 21, 1957, the bankrupt was adjudicated a voluntary bankrupt, and proceedings are now pending in said matter before the Honorable Michael J. Kerley, Referee in Bankruptcy.

IV.

During the month of December, 1954, the exact date being unknown to your petitioner, the bankrupts purchased a sewing machine and refrigerator from Sears Roebuck and Company under a contract of conditional sale, purporting to reserve title in the vendor until full payment of the purchase price.

V.

Notwithstanding the provisions and requirements of the statutes of the State of Washington that a signed memorandum of any contract of conditional sale, setting forth its terms and conditions, shall be filed in the office of the Auditor of the county wherein the purchaser resides at the time possession of said property was taken, within ten (10) days after such taking of possession by the purchaser, no such memorandum of sale was filed in such manner in the office of the Auditor of Spokane County, which was the county wherein the bankrupt resided at the time of the taking possession of such personal property. On account of the failure to file said contract, said sale became absolute as to the rights of

this trustee in bankruptcy. Subsequently the bankrupt became indebted to a large number of unsecured creditors whose claims remain unpaid.

VI.

Sears, Roebuck and Company retains indicia of ownership to said personal property and it is proper that it be required to surrender the same to your petitioner. [5]

VII.

Your petitioner desires to avoid all of the rights of the vendor aforesaid and of any successor in interest to he rights of said vendor, reserving, however, any and all rights which it may have as successor in interest to the vendor for the benefit of the bankrupt estate.

VIII.

The unpaid balance claimed to be owing on said contract of conditional sale is $231.72. It is proper that the bankrupt be required to surrender possession of said property to your petitioner.

Wherefore, your petitioner prays that an order be entered requiring:

(1) That Sears Roebuck and Company appear and show cause, at a time and place to be fixed by the Court, why the purported conditional sales contract aforesaid should not be deemed to be an absolute sale as to the rights of this trustee in bankruptcy, and why it should not be required to sur-

render and transfer to your petitioner all evidence or indicia of ownership in and to said personal property;

(2) That the bankrupt appear and show cause why he should not be required forthwith to surrender to your petitioner the personal property involved in this proceeding.

/s/ SIDNEY SCHULEIN,
Trustee in Bankruptcy.

State of Washington,
County of Spokane—ss.

Sidney Schulein, being first duly sworn on oath deposes and says:

That he is the trustee in bankruptcy of the estate of the above named bankrupt and petitioner herein; that he has read the within and foregoing Petition, knows the contents thereof, and believes the same to be true.

/s/ SIDNEY SCHULEIN.

Subscribed and sworn to before me this 15th day of March, 1957.

[Seal] /s/ GRAYCE M. NEWMAN,
Notary Public in and for the State of Washington, residing at Spokane. [6]

[Endorsed]: Filed March 15, 1957.

[Title of District Court and Cause.]

ORDER DECLARING CONDITIONAL SALE CONTRACT OF SEARS ROEBUCK AND COMPANY TO BE ABSOLUTE SALE

At Spokane, in said District, March 25, 1957.

This matter came on for hearing this day upon the petition of Sidney Schulein, trustee in bankruptcy, to declare a certain contract of conditional sale to be an absolute sale, to-wit, a contract wherein Sears Roebuck & Company is the vendor and the bankrupts are the vendees, the trustee appearing personally, and neither Sears Roebuck and Company nor the bankrupts appearing, and the Court having heard and considered the matter, and being sufficiently advised, finds:

That all matters and things set forth in the trustee's petition aforesaid are true.

From the foregoing findings, the Court makes the following

Conclusions of Law

1. That the conditional sale contract aforesaid is an absolute sale as to the rights of the trustee in bankruptcy on account of the failure of the vendor to file said contract in the office of the Spokane County Auditor within ten (10) days after the vendees took possession of the personal property described in said contract.

Wherefore, It Is Ordered, Adjudged and Decreed that he said Sears Roebuck and Company has no

right, title or claim or interest in or to any of the personal property described in said contract of conditional sale, and said sale was an absolute sale as to the rights of the trustee in bankruptcy. [7]

It Is Further Ordered that all of the rights of said Sears Roebuck and Company, the vendor under said contract, be and they are hereby preserved for the benefit and use of the bankrupt estate, and as a condition to retaining possession of said personal property the bankrupts shall pay to the trustee the unpaid balance owing thereon, to-wit, the sum of $231.72, in the same manner as is prescribed in the original contract of conditional sale.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [8]

[Endorsed]: Filed March 25, 1957.

[Title of District Court and Cause.]

PETITION TO RE-OPEN SHOW CAUSE PROCEEDINGS

Comes Now Sears, Roebuck and Co., through Paine, Lowe, Coffin and Herman, its attorneys, and respectfully petitions the Referee to re-open the show cause proceedings and alleges as follows:

I.

Heretofore the Trustee petitioned the Referee for a show cause order, setting out in the petition dated

March 15, 1957, that the above named Bankrupts had purchased a sewing machine and refrigerator from Sears, Roebuck and Co. under conditional sale contracts, which contracts had not been recorded.

II.

That the Referee heretofore, on March 15, 1957, issued a show cause order directed to Sears, Roebuck and Co. based on the above petition, setting March 25, 1957, for hearing on such order.

III.

That on the hearing, Sears, Roebuck and Co. not appearing, petitioner is informed that the Referee entered its order directing that Sears, Roebuck and Co. had no further right, title or interest in or to the sewing machine and refrigerator.

IV.

That Sears, Roebuck and Co. did not receive a copy of the show cause order within five (5) days prior to the hearing and, in fact, not until March 29, 1957, at which time the order had already been entered. [9]

V.

That Sears, Roebuck and Co. believes it has good and sufficient legal grounds for claiming an interest in the personal property in the event such property is claimed as exempt by the Bankrupts and set aside as exempt property by the Trustee; that no order should be entered against Sears, Roebuck

and Co. until the Trustee has allowed the exempt property, as required by the Bankruptcy Act.

VI.

That the show cause hearing referred to should be re-opened in order to permit the rights and interests of the parties in the personal property in question to be determined, and the Trustee should be ordered to set aside exempt property as claimed by the Bankrupts and that no order should be entered against Sears, Roebuck and Co. until such has been accomplished.

VII.

That the re-opening of the show cause hearing will work no hardship on the Trustee, the Bankrupts or the creditors of the Bankrupts and that such re-opening would not be detrimental to the Bankrupts' estate or the creditors of the Bankrupts.

Wherefore, your petitioner prays that the Referee, after such notice as is deemed necessary to the Trustee and the Bankrupts, set aside the order entered March 25, 1957, and fix a new date for hearing the show cause order, as formerly set out.

PAINE, LOWE, COFFIN AND HERMAN,
/s/ By JOHN HUNEKE,
Attorneys for Sears, Roebuck & Co.

Duly Verified. [11]

[Endorsed]: Filed April 19, 1957.

[Title of District Court and Cause.]

ORDER TO SHOW CAUSE

At Spokane, in said District, April 23, 1957:

Upon reading the verified Petition To Re-Open Show Cause Proceedings in the estate of the above named Bankrupt, it is

Ordered, that said matter be re-opened and that Sears, Roebuck and Co. appear before the undersigned Referee in Bankruptcy, at his office in Room 338 Federal Building, in the City of Spokane, on the 13th day of May, 1957, at the hour of 10:00 o'clock A.M., on said day, then and there to show cause if any there be, why the prayer of the Trustee's Petition heretofore filed in the above entitled action, should not be granted.

It Is Further Ordered that the above named Bankrupt likewise appear at the time and place mentioned, then and there to show cause, if any he has, why he should not be required forthwith to surrender such personal property to the Trustee.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [12]

[Endorsed]: Filed April 23, 1957.

[Title of District Court and Cause.]

ANSWER TO PETITION TO DECLARE CONTRACT OF CONDITIONAL SALE TO BE ABSOLUTE SALE

Comes Now Sears, Roebuck and Co. and in answer to the Petition of the Trustee to declare a contract of conditional sale to be an absolute sale, alleges as follows:

Sears, Roebuck and Co. admits the allegations of paragraphs I, II and III of said Petition.

Sears, Roebuck and Co. states that the following items were purchased from Sears, Roebuck and Co. on the dates shown and for the amounts set opposite thereto:

Sewing Machine	12/18/54	$197.00
Refrigerator	7/25/55	211.95

that such purchases were made under conditional sale contracts, which contracts have not been recorded.

Sears, Roebuck and Co. denies the allegations set out in paragraphs V, VI and VII of the Petition above referred to and admits the balance due on the above purchases as set out in paragraph VIII in the Petition.

Sears, Roebuck and Co. states that the Trustee should first be required to designate the specific exempt property of the Bankrupts and the market value of each item thereof, as of the date of bankruptcy.

Sears, Roebuck and Co. states that the Trustee should be required to set aside the above items of personal property as exempt and that on such determination the Trustee then be determined to have no right, title or interest in or to such property.

Wherefore, Sears, Roebuck and Co. prays that the Trustee be [13] required to designate the specific exempt property, to determine its valuation as set out above and that as to such property the Trustee be declared to have no right, title or interest and that the Order To Show Cause be dismissed.

Dated this 16th day of May, 1957.

PAINE, LOWE, COFFIN AND HERMAN,

/s/ By JOHN HUNEKE,

Attorneys for Sears, Roebuck and Co. [14]

[Endorsed]: Filed May 16, 1957.

[Title of District Court and Cause.]

TRUSTEE'S REPORT OF EXEMPT PROPERTY

To Michael J. Kerley, Referee in Bankruptcy:

The following is a schedule of property designated and set apart to be retained by the bankrupt aforesaid as his own property, under the provisions of the Act of Congress relating to bankruptcy, as

his exemptions allowed by law and claimed by him in his schedules filed in the above entitled proceeding.

General Head: Property claimed to be exempt by the laws of the United States, with reference to the statute creating the exemption .....

General Head: Property claimed to be exempt by State laws, with reference to the statute creating the exemption: Particular Description: Lot 19 Block 20 Empire Addition Spokane County, Washington RCW 6.12.010 Equity Estimated Value: $180.00.

Household furniture, furnishings, clothing and New Standard encyclopedia, Subject, however, to claim of lien of the Trustee arising out of preservation of chattel mortgage lien of Budget Finance Plan, and seller's interest in conditional sales contract of Sears-Roebuck RCW 6.16.010 et seq. 11 USCA § 24 (§6 Bankruptcy Act) Equity to the extent of any excess over described liens.

Dated this 16th day of May, 1957.

/s/ SIDNEY SCHULEIN,
Trustee. [15]

[Endorsed]: Filed May 16, 1957.

[Title of District Court and Cause.]

OBJECTIONS TO TRUSTEE'S REPORT OF EXEMPT PROPERTY

Comes now Sears, Roebuck and Company, through Paine, Lowe, Coffin and Herman, its attorneys of record, and objects to the Trustee's report of exempt property and allowance of exemptions in the above bankruptcy estate, on the following facts and for the following reasons:

I.

The Trustee failed to take into his possession and set apart from property in the bankruptcy estate, any property as exempt to the bankrupts and the Trustee has, at all times, left possession of all property herein mentioned with the bankrupts.

II.

That included in household goods and furniture of the bankrupts are the following items purchased from Sears, Roebuck and Company on conditional sale contract, as set out in the Answer to the Show Cause Order on file herein:

Sewing Machine, and
Refrigerator

III.

That the Petition for Bankruptcy was filed February 21, 1957, and no Trustee's Report of Exempt Property was filed until May 16, 1957, which is con-

trary to the duties imposed by the Trustee by the Bankruptcy Act.

IV.

The Trustee has failed to fix a true valuation on the property set aside as exempt and on specific items therein and has, instead, [16] set out an indeterminant valuation based on an equity to the extent of any excess over described liens.

V.

The Trustee, by his actions, arbitrarily attempts to defeat the interest of the bankrupts in such property and the interest of Sears, Roebuck and Company by removing ordinarily exempt property from the claim of exemptions and in attempting to force the bankrupts to purchase such exemptions from their own estate.

VI.

The Trustee has made no effort to sell the property set aside to the bankrupts or that exempt from the report of exempt property, and has made no attempt to realize on such property for the benefit of the bankrupts' estate.

VII.

That as a result of the Trustee's acts, as set forth above, the rights of the bankrupts, the rights of Sears, Roebuck and Company and the rights of general creditors have all been affected detrimentally

and the Referee should not enter his approval of the report on exemptions, but rather the Trustee should be required to set out specific items of exempt property including the sewing machine and refrigerator referred to above and should also be required to set out the true valuation of each item.

Wherefore, Sears, Roebuck and Company prays that the approval of the Referee be withheld and that action be taken by the Referee requiring the Trustee to act as set forth above.

Dated this 27th day of May, 1957.

PAINE, LOWE, COFFIN AND HERMAN,
/s/ By JOHN HUNEKE,
Attorneys for Sears, Roebuck and Company. [17]

Duly Verified.

[Endorsed]: Filed May 27, 1957.

[Title of District Court and Cause.]

ORDER APPROVING TRUSTEE'S REPORT OF EXEMPTIONS

At Spokane, Washington, in said district, on the 27th day of May, 1957.

It appearing to the Court that the trustee herein has more than ten (10) days prior to the entry of this order filed his report of exempted property in

accordance with law, and no objections having been taken thereto,

It Is Ordered that the said trustee's report of exempted property be and the same hereby is, in all things confirmed, and the bankrupt's claim to exemptions is hereby allowed accordingly.

It Is Further Ordered that the property specified in such report be and the same is hereby set apart to the bankrupt as exempt and ordered delivered to said bankrupt forthwith.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [19]

[Endorsed]: Filed May 27, 1957.

[Title of District Court and Cause.]

PETITION FOR REVIEW

Comes now Sears, Roebuck and Company, through Paine, Lowe, Coffin and Herman, its attorneys, and petitions the District Judge in the above entitled Court to review the order of the Referee herein referred to and alleges:

I.

That heretofore, on March 25, 1957, Michael J. Kerley, as Referee, signed an order in the above entitled matter, a copy of which is attached hereto as Exhibit A and by this reference made a part of this petition; that subsequently, on May 16, 1957,

Michael J. Kerley, as Referee, announced his oral decision reopening the above matter and granting the Trustee's petition and affirming the order declaring conditional sale absolute as to Sears; that no formal order has been entered but that your petitioner files this petition for review in order to protect its rights on appeal within ten (10) days after the declaration of such decision.

II.

That the order referred to is in error in the following particulars:

(a) The Referee failed to require the Trustee to itemize property to be set aside as exempt, particularly including the sewing machine and refrigerator referred to in the answer of this petitioner to the show cause order.

(b) The Referee failed to require that the Trustee fix a market value of such items as of the date of bankruptcy and to fix such market value on each specific item, particularly the sewing machine [20] and refrigerator.

(c) In declaring that Sears, Roebuck and Company had no right, title, or claim, or interest in or to such personal property, including the sewing machine and refrigerator.

(d) In ordering the terms of the conditional sale contract with Sears, Roebuck and Company to be enforced against the bankrupts.

III.

That the Referee should have determined his order on the following principles:

(a) The claim of exemption by the bankrupts and the allowance of such exempt property by the Trustee must be of specific items in order to determine which household goods and furniture are to be set out as exempt and which items are to be retained by the Trustee in the bankrupts' estate.

(b) That a specific valuation of each item is necessary to determine if such allowances are within the State statutory exemptions.

(c) That as to certain items claimed as exempt, particularly a sewing machine and refrigerator, if set aside as exempt property, are no longer part of the bankrupts' estate or there is no right, title or interest of Sears, Roebuck and Company to turn over to the Trustee.

(d) The Trustee has no power to compel the bankrupts to buy their own exemptions or to pay out of subsequently acquired monies, any such money into the bankrupt estate.

Wherefore, petitioner prays that the record be certified to the above entitled Court; that this review be considered and the Court enter its order reversing the order of the Referee and sending the

matter back for further consideration and action in accordance with the terms of this petition.

PAINE, LOWE, COFFIN AND HERMAN,
/s/ By JOHN HUNEKE,
Attorneys for Sears, Roebuck and Company. [21]

Duly Verified.

[Note: Exhibit A "Order" is set out at pages 13-14.]

[Endorsed]: Filed May 27, 1957.

[Title of District Court and Cause.]

ORDER AFFIRMING ORDER DECLARING CONDITIONAL SALE CONTRACT OF SEARS ROEBUCK AND COMPANY ABSOLUTE SALE

At Spokane, Washington, in said District, on the 16th day of October, 1957.

The above entitled matter having come on for hearing May 16, 1957 upon the Petition of Sears Roebuck and Company to re-open show cause proceedings and particularly to set aside an Order of the Referee entered March 25, 1957 declaring the conditional sale contract of Sears Roebuck and Company an absolute sale, Sears Roebuck and Company having been represented by its attorney, John

Huneke, and the Trustee by himself, and the matter having been submitted without argument, it is

Ordered that for the purpose of argument the Order of March 25, 1957 be and the same is hereby re-opened, and

It Is Further Ordered that the said Order of March 25, 1957 be and the same is hereby affirmed.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [25]

[Endorsed]: Filed October 16, 1957.

[Title of District Court and Cause.]

CERTIFICATE BY REFEREE TO JUDGE

At Spokane, Washington, in said District, on the 16th day of October, 1957.

To the Honorable Sam M. Driver, District Judge:

I, Michael J. Kerley, Referee in Bankruptcy of said Court, do hereby certify that in the course of this proceeding before me, upon hearing the Trustee's Petition to Declare Contract of Conditional Sale to Be Absolute Sale by Sears Roebuck and Company to the bankrupt, the following situation arose:

On December 18, 1954, Baldwin purchased from Sears Roebuck and Company a sewing machine for $197.00, and on July 25, 1955, he purchased a refrigerator for $211.95. Both items were bought under conditional sale contracts which were never re-

corded. On February 21, 1957 Baldwin filed a voluntary Petition in Bankruptcy and was adjudicated a bankrupt February 25, 1957. In his Schedules the bankrupt claimed as exempt personal property "Household furniture—furnishings," including the sewing machine and refrigerator.

March 15, 1957 the Trustee petitioned the Referee to have the Sears Roebuck conditional sale contracts declared absolute sales as to the Trustee because of lack of recordation. On March 25, 1957, the time set by notice on hearing of the matter, Sears Roebuck and Company did not appear; and an Order was entered Declaring the Conditional Sale Contract of Sears Roebuck and Company to be an absolute sale and preserving the rights of Sears Roebuck for the benefit of the estate. Subsequently Sears Roebuck and Company [26] petitioned to have this matter re-opened and it was re-opened and the question of invalidating said conditional sale contracts was reconsidered by the Referee on March 16, 1957 at which time the Referee orally announced that the order invalidating the contracts would stand.

On May 16, 1957 the Trustee filed his Report of Exempt Property. On May 17, 1957 Sears Roebuck and Company filed Objections to Trustee's Report of Exempt Property, and as of May 27, 1957 an Order was entered approving the Trustee's Report of Exemptions. Subsequently an Order was entered Affirming Order Declaring Conditional Sale Contract of Sears Roebuck and Company Absolute Sale.

The issue raised by Sears Roebuck and Company presented these questions:

1. Is the Trustee entitled to attack and take over for the benefit of the estate unrecorded conditional sale contracts where the bankrupt claims the covered personal property as exempt? I decided the Trustee was so entitled.

2. Was Sears Roebuck and Company in a position to have the Trustee ordered to itemize, and evaluate and set aside as exempt to the bankrupt the sewing machine and refrigerator so that these items would thus become the property of the bankrupt and not subject to an attack by the Trustee for lack of recordation of the conditional sale contracts? I decided Sears Roebuck and Company was in no such position.

There seemed to be no dispute between the parties as to the facts so I am not appending the usual summary of the evidence.

Thereafter and timely Sears Roebuck and Company filed a Petition for Review.

The undersigned Referee hereby certifies that the following enumerated instruments are the original instruments in each instance filed [27] in his office in this proceeding.

1. Schedule B-5.

2. Schedule B-2.

3. Order Declaring Conditional Sale Contract of Sears Roebuck and Company to be Absolute Sale.

4. Order to Show Cause (and Re-Opening).

5. Answer (of Sears Roebuck and Company) to Petition to Declare Contract of Conditional Sale to be Absolute Sale.

6. Trustee's Report of Exempt Property.

7. Objections to Trustee's Report of Exempt Property.

8. Order Approving Trustee's Report of Exemptions.

9. Petition for Review.

10. Order Affirming Order Declaring Conditional Sale Contract of Sears Roebuck and Company Absolute Sale.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [28]

[Endorsed]: Filed October 16, 1957.

[Title of District Court and Cause.]

MEMORANDUM OF POINTS AND AUTHORITIES FOR SEARS, ROEBUCK AND COMPANY

Sears, Roebuck and Company presents the following Memorandum of Points and Authorities to sustain its position that when the bankrupt claims as exempt certain household goods and furniture, including in this case a sewing machine and refrigerator purchased on conditional sales contract, not recorded, that the Trustee should then allow exemptions in accordance with the Washington State Statutes and include such items if within the statu-

tory allowance of value and in order to determine the fact of value, the Trustee should itemize and evaluate such items of exempt property.

It is the further position of Sears, Roebuck and Company that the Trustee cannot ignore the question of value as of the date of bankruptcy and cannot arbitrarily attempt to enforce the balance of any purchase price of such items against the bankrupt.

The basic question with which we are here concerned is arising with minor variations in many bankruptcies in this State and is based on similar factual situations in which there are items of household furniture and fixtures purchased under conditional sales contracts, which contracts are not recorded, and which items are subsequently claimed as exempt by the bankrupt.

It is conceded that under Washington State Statutes, the failure to record a conditional sale contract results in an absolute title in the purchaser as far as subsequent creditors are concerned.

It is also conceded that as such title is absolute unless the property covered thereby is claimed as exempt, title vests in the Trustee and there is nothing else to which the Trustee can succeed. [29]

The question arises when such property is includable as exempt property then the Trustee must place a value on it and itemize and allow exemptions in accordance with bankruptcy law. The dispute then arises between Trustees who attempt to recover the balance of the purchase price of such items from the bankrupt and Sears which insist

that if the property is exemptable under State law, the Trustee can have no claim upon it, nor recover the purchase price against the bankrupt.

These points and authorities are set out only in outline form and not as a complete brief. It must be recognized that Trustees have no title to exempt property and no right to administer exempt property in the bankrupt's estate:

In re Urban, 136 F. (2d) 296.

Van Slyke v. Bumgarner, 177 Wash. 336, 31 P. (2d) 1014.

In re Durham, 104 Fed. 231.

Baumbaugh v. Los Angeles Morris Plan Co., 30 F. (2d) 816.

In order to determine whether property included in the class of statutory exemptions is exemptable, a market value as of the date of bankruptcy must be placed upon each item (this is true even if the Trustee's theory of setting aside an "equity" is followed):

R.C.W. 6.16.020(3).

Sears v. McAllister, 184 F. (2d) 487.

William A. Finley Bankrupt, No. 42362, Western District of Washington, Northern Division.

Kilgo v. United Distributors, 223 F. (2d) 167.

If property is found to be within the statutory exemption then the Trustee has no rights in such property and title cannot be turned over to the Trustee and it is the duty of the Trustee to set such exempt property over to the bankrupt:

George Nin Woo Bankruptcy, No. 37956, Western District of Washington, Northern Division.

Sherman Clifford Sprinkle, Jr. Bankrupt, No. 39291, Western District of Washington, Northern Division. [30]

In re Lippow, 92 F. (2d) 619.

Kilgo v. United Distributors, (supra).

In such a situation it makes no difference that the property involved may have been mortgaged or purchased under a conditional sale contract:

In re Lippow (supra).

Personal Finance Company of Chicago v. Silver, 64 N.E. (2d) 398.

A Trustee in bankruptcy is not a bona fide purchaser but is in the position of an ideal creditor, an attachment creditor and an unsatisfied judgment creditor armed with process. The purchase under a conditional sale contract is not in the nature of a transfer and there is no creditor of any sort to complain:

Anderson Buick Company v. Cook, 7 Wn. (2d) 632, 110 P. (2d) 857.

Reconstruction Finance Corp. v. Hambright, 16 Wn. (2d) 81, 133 P. (2d) 278.

Baumbaugh v. Los Angeles Morris Plan Co. (supra).

A Trustee in bankruptcy cannot enforce the balance of the purchase price of a conditional sale contract against the bankrupt and cannot force the bankrupt to pay additional money into the estate in order to purchase his exemptions:

11 U.S.C.A. 110 (Note 781 and citations thereunder).

It is believed that the errors referred to in the Petition for Review and the legal principles relied on have been covered in the above statement of points and authorities. It is submitted that the Order of the Referee should be reversed and the matter sent back for further action requiring the Trustee to evaluate and itemize the various items of personal property claimed as exempt by the bankrupt and that such items should be set aside to the bankrupt as exempt.

Respectfully submitted,

PAINE, LOWE, COFFIN AND HERMAN,
By JOHN HUNEKE,
Attorneys for Sears, Roebuck and Company. [31]

[Endorsed]: Filed October 29, 1957.

[Note: Letter of Judge Driver is set out in the Memorandum of Decision and Order at pages 56-62.]

[Title of District Court and Cause.]

ORDER ON PETITION FOR REVIEW

This matter came on regularly for hearing before the Court on November 8, 1957, upon petition of Sears, Roebuck and Company for a review of that certain order of the referee, entered October 16, 1957, wherein the referee affirmed an order

entered March 25, 1957, declaring the sales by Sears, Roebuck and Company under conditional sales contracts, as absolute sales, and preserving the rights of said company under the contracts for the use and benefit of the bankrupt estate, and ordering payment of the balance of the purchase price to the trustee. The Court has heard arguments of counsel and read the petition for review, referee's certificate on review, and memoranda of petitioner and trustee, and is fully advised in the premises.

It Is Now, Therefore, Ordered that this matter be remanded to the referee, who is hereby instructed to make or cause to be made a list of the items of property and the estimated values thereof claimed as exempt by the bankrupts, to set off such exemptions, or cause them to be set off, if such has not heretofore properly been done, and specifically to find whether the property covered by the above referred to conditional sales contracts constitute a part thereof; that the referee give notice of his proposed findings and conclusions as aforesaid to the attorneys for the trustee, the bankrupt, and Sears, Roebuck and Company, giving them an opportunity to be heard and object thereto. After the determination of the exempt property, the referee shall reconsider the order hereinabove mentioned involved in this review proceeding, making such changes therein as he [36] deems appropriate as a result of the findings made and conclusions reached pertaining to the exempt property, and that such order as the referee may then make, or cause to be

made, shall be subject to review in the same manner as any other order entered by the referee.

Done this 28th day of February, 1958.

/s/ SAM M. DRIVER,
United States District Judge.

Notice of Mailing Attached. [37]

[Endorsed]: Filed February 28, 1958.

[Title of District Court and Cause.]

ORDER APPROVING TRUSTEE'S AMENDED REPORT OF EXEMPTIONS

At Spokane, Washington, in said district, on the 12th day of May, 1958.

It appearing to the Court that the trustee herein has more than ten (10) days prior to the entry of this order filed his report of exempted property in accordance with law, and no objections having been taken thereto,

It Is Ordered that the said trustee's report of exempted property be and the same hereby is, in all things confirmed, and the bankrupt's claim to exemptions is hereby allowed accordingly.

It Is Further Ordered that the property specified in such report be and the same is hereby set apart to the bankrupt as exempt and ordered delivered to said bankrupt forthwith.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [38]

[Endorsed]: Filed May 12, 1958.

[Title of District Court and Cause.]

CERTIFICATE OF REFEREE TO JUDGE

At Spokane, Washington, in said District, on the 30th day of March, 1959.

To the Honorable William J. Lindberg, District Judge:

I, Michael J. Kerley, Referee in Bankruptcy for this District, do hereby certify that in the course of proceedings the following questions were presented for decision:

(1) Where the Trustee in bankruptcy has set aside to the bankrupt as exempt the bankrupt's interest or equity in personal property to the extent of the excess in value of said interest or equity over the unpaid balances payable under unrecorded conditional sale contracts, are these two transactions absolute sales as to the Trustee for lack of recordation under R.C.W. 6.16.020 and .080?

I held them to be absolute sales as to the Trustee.

(2) As to the foregoing facts, is the Trustee entitled to take over and preserve for the benefit of the bankrupt estate the vendor's lien interests in the unrecorded conditional sale contracts?

I held the Trustee to be so entitled under Sec. 6 of the Bankruptcy Act (11 U.S.C. #24) and Sec. 70 of the Bankruptcy Act (11 U.S.C. #110).

These holdings came about as the result of an "Order on Petition for Review" entered herein January 28, 1958, by Hon. Sam M. Driver, in which Order the Trustee was directed to again set off the

bankrupt's exemptions, and that the Referee give notice of his proposed findings, etc., and that the Referee should reconsider the matter, etc. [39]

After the Trustee filed his Amended Report of Exempt Property, and upon due notice to counsel for Sears Roebuck, vendor under the conditional sale contracts in question, I entered Supplemental Findings of Fact and Conclusions of Law and Supplemental Order Declaring Conditional Sales Contracts of Sears Roebuck & Co. to Be Absolute Sales and Preserving Lien or Interest for Benefit of Bankrupt Estate. Subsequently and timely, Sears Roebuck filed herein its Petition for Review.

The undersigned Referee hereby certifies that the attached enumerated instruments are the original instruments in each instance filed in his office in this proceeding.

1. Order (of Judge) on Petition for Review.

2. Trustee's Amended Report of Exempt Property.

3. Supplemental Order to Show Cause Why Conditional Sales Contracts Should Not Be Declared Absolute Sales and the Lien Thereof Preserved for the Benefit of the Bankrupt Estate.

4. Supplemental Findings of Fact and Conclusions of Law.

5. Supplemental Order Declaring Conditional Sales Contracts of Sears Roebuck & Co. to Be Absolute Sales and Preserving Lien or Interest for Benefit of Bankrupt Estate.

6. Petition for Review.

Also transmitted herewith but not as part of the record are copies of letter from Hon. Sam M. Driver dated December 10, 1957, in the instant case pertaining to the first Petition for Review filed and heard herein, and the Memorandum of Points and Authorities for Sears, Roebuck and Company filed at the hearing of the first Petition for Review, for such use as your Honor may see fit to make.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [40]

[Note: Order on Petition for Review appearing here is the same as set out at pages 35-37.]

[Title of District Court and Cause.]

TRUSTEE'S AMENDED REPORT OF EXEMPT PROPERTY

To Michael J. Kerley, Referee in Bankruptcy:

The following is a schedule of property designated and set apart to be retained by the bankrupt aforesaid as his own property, under the provisions of the Act of Congress relating to bankruptcy, as his exemptions allowed by law and claimed by him in his schedules filed in the above entitled proceeding.

General Head—Particular Description the laws of the United States, with reference to the statute creating the exemption	Estimated Value .....

Property claimed to be exempt by State laws, with reference to the statute creating the exemption:			
Household furnishings as follows:			
Daveno	$20.00		
Overstuffed chair	10.00		
End tables	5.00		
Lamp	2.50		
Arvin radio	5.00		
Chrome kitchen set, with 4 chairs	25.00		
2 baby beds	20.00		
1 wardrobe chest	10.00		
1 bed and 2 dressers	50.00		
1 Hotpoint range	35.00		
1 Maytag washer	20.00		
New Standard Encyclopedia	10.00		
Wearing apparel and personal effects	10.00		
Coldspot refrigerator—equity	50.00*	Value	$200.00
Kenmore sewing machine—equity	35.00	"	116.72
* These two items, at the time the petition was filed, were being purchased from Sears Roebuck & Co. under conditional sales contracts, the lien of which the trustee reserves the right to preserve for the benefit of the bankrupt estate.			$320.00

Dated this 30th day of April, 1958.

/s/ SIDNEY SCHULEIN,
Trustee. [43]

Acknowledgment of Receipt of Copy Attached.

[Endorsed]: Filed May 1, 1958.

[Title of District Court and Cause.]

SUPPLEMENTAL ORDER TO SHOW CAUSE WHY CONDITIONAL SALES CONTRACTS SHOULD NOT BE DECLARED ABSOLUTE SALES AND THE LIEN THEREOF PRESERVED FOR THE BENEFIT OF THE BANKRUPT ESTATE

At Spokane, in said District, May 1, 1958.

This matter coming on for hearing this day, pursuant to the order of the Honorable Sam M. Driver, United States District Judge, entered February 28, 1958, wherein the above entitled Court was directed to do certain things, and it appearing that exemptions have been duly set aside to the bankrupts, and that the trustee has submitted for signature of the Referee proposed Findings of Fact and Conclusions of Law and Order, and it further appearing that Sears Roebuck & Co. should be afforded an opportunity to be heard and object to the entry of said Findings, Conclusions and Decree; it is

Ordered that Sears Roebuck & Co. appear before the undersigned Referee in Bankruptcy, at his office in Room 338 Federal Building, in the City of Spokane, on the 12th day of May, 1958, at the hour of 2:15 o'clock p.m. of said day, then and

there to show cause, if any it has, why the proposed Supplemental Findings of Fact and Conclusions of Law and Supplemental Order, copies of which are hereto attached and by reference made a part hereof, should not be signed by the Court, why the purported conditional sales contracts described in said Findings should not be declared to be absolute sales as to the rights of the trustee in bankruptcy, and why Sears Roebuck & Co. should not be required to surrender and transfer to the trustee all indicia of ownership of the personal property described therein, and why the interests of Sears Roebuck & Co. should not be preserved for the benefit of the bankrupt estate. [44]

It Is Further Ordered that a certified copy of this Order to Show Cause, together with copies of said proposed Supplemental Findings of Fact and Conclusions of Law and Supplemental Order, be served upon said Sears Roebuck & Co. by mailing copies thereof to it at the address set forth below:

Sears Roebuck & Co.
c/o Paine, Lowe, Coffin & Herman
Attention: John Huneke
Attorneys at Law
Spokane & Eastern Building
Spokane 1, Washington

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [45]

Acknowledgment of Service Attached.

[Endorsed]: Filed May 1, 1958.

[Title of District Court and Cause.]

SUPPLEMENTAL FINDINGS OF FACT AND CONCLUSIONS OF LAW

At Spokane, in said District, May 13, 1958.

This matter came on for hearing this day, pursuant to the order of the Honorable Sam M. Driver, United States District Judge, dated February 28, 1958, the trustee, Sidney Schulein, appearing personally, and Sears Roebuck & Co. appearing by its attorneys, Paine, Lowe, Coffin & Herman, John Huneke of counsel, and the Court having heard arguments of counsel, and having heretofore approved exemptions of the bankrupts in accordance with the trustee's report of exemptions, and notice having been given to the parties hereto, giving them an opportunity to be heard and object to these proceedings, and the Court having reconsidered its orders entered March 25, 1957, and October 16, 1957, the Court does hereby make the following

Findings of Fact

I.

Sidney Schulein is the duly appointed, qualified and acting trustee in bankruptcy of the estate of the above named bankrupts.

II.

By virtue of a voluntary petition in bankruptcy filed in the above entitled Court on February 21, 1957, the bankrupts were adjudicated voluntary

bankrupts, and proceedings are now pending in said matter before the Honorable Michael J. Kerley, Referee in Bankruptcy. [46]

III.

The bankrupts, as vendees, purchased from Sears Roebuck & Co., as vendor, a Kenmore sewing machine for the sum of $197.00 and a Coldspot refrigerator for the sum of $211.95, under contracts of conditional sale dated December 18, 1954 and July 25, 1955, respectively, which contracts purported to reserve title in the said vendor until full payment of the purchase price; that both such items of personal property were claimed exempt by the bankrupts in their schedules filed herein, at a time when the combined balance due thereon was $231.72 and at which time the bankrupts had an equity of $85.00 therein; that on the date of the filing of the petition, February 21, 1957, said sewing machine and refrigerator had a fair market value of $116.72 and $200, respectively; that said items of personal property, pursuant to the trustee's report on exemptions, have been set aside to the bankrupts, to the extent of the excess in value thereof, as found by the trustee, over the unpaid balance due thereon, reserving unto said trustee the right to preserve the interest of the vendor under said conditional sales contracts for the benefit of the bankrupt estate.

IV.

Notwithstanding the provisions and requirements of the statutes of the State of Washington that a

signed memorandum of any contract of conditional sale, setting forth its terms and conditions, shall be filed in the office of the Auditor of the County wherein the purchaser resides at the time possession of said property was taken, within ten (10) days after such taking of possession by the purchaser, no such memorandum of sale was ever filed in such manner in the office of the Spokane County Auditor, which was the county wherein the bankrupts resided at the time of the taking of possession of such personal property. On account of the failure to file said contract, said sale became absolue as to the rights of the trustee in bankruptcy. Subsequently the bankrupt became indebted to a large number of unsecured creditors, whose claims remain unpaid. [47]

V.

Sears Roebuck and Company retains indicia of ownership to said personal property and it is proper that it be required to surrender the same to the trustee.

VI.

The Trustee desires to avoid all of the rights of Sears Roebuck & Co. in and to said property and to preserve the rights and interests of said vendor for the benefit of the bankrupt estate.

From the foregoing Findings of Fact, the Court makes the following:

Conclusions of Law

1. That said contracts of conditional sale should be declared absolute as to the rights of the trustee in bankruptcy, representing creditors subsequent in time to the execution of said contracts and the delivery of the property thereunder to the bankrupts, and that any lien or interest of the vendor, Sears Roebuck & Co., should be preserved for the benefit of the bankrupt estate.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [48]

Acknowledgment of Service Attached.

[Endorsed]: Filed May 13, 1958.

[Title of District Court and Cause.]

SUPPLEMENTAL ORDER DECLARING CONDITIONAL SALES CONTRACTS OF SEARS ROEBUCK & CO. TO BE ABSOLUTE SALES AND PRESERVING LIEN OR INTEREST FOR BENEFIT OF BANKRUPT ESTATE

At Spokane, in said District, May 13, 1958.

This matter came on for hearing this day pursuant to the order of the Honorable Sam M. Driver, United States District Judge, dated February 28, 1958, the trustee, Sidney Schulein, appearing personally, and Sears Roebuck & Co. appearing by its

attorneys, Paine, Lowe, Coffin & Herman, John Huneke of counsel, and the Court having heretofore entered its Supplemental Findings of Fact and Conclusions of Law herein; it is

Ordered, Adjudged and Decreed that Sears Roebuck & Co. has no right, title, claim or interest in or to any of the personal property described in said conditional sales contracts, and said sales are absolute as to the rights of the trustee in bankruptcy.

It Is Further Ordered, Adjudged and Decreed that all of the rights of said Sears Roebuck & Co. be and they are hereby preserved for the benefit of the bankrupt estate, and as a condition to retaining possession of said Kenmore sewing machine and Coldspot refrigerator the bankrupts shall pay to the trustee the unpaid balance owing thereon, to-wit, the sum of $231.72, in the same manner as is prescribed in the original contract of conditional sale.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy. [49]

Acknowledgment of Service Attached.

[Endorsed]: Filed May 23, 1958.

[Title of District Court and Cause.]

PETITION FOR REVIEW

To Michael J. Kerley, Referee in Bankruptcy:

Comes now Sears, Roebuck & Company through Paine, Lowe, Coffin and Herman its attorneys, and petitions the above entitled referee as follows:

I.

That Petitioner is aggrieved by the order hereinafter referred to affecting the rights, duties and obligations of the Petitioner in connection with the above bankruptcy.

II.

That heretofore on May 13, 1958, the above named Referee signed supplemental Findings of Fact and Conclusions of Law and supplemental Order Declaring Conditional Sales Contracts of Sears, Roebuck & Company to be absolute sales and preserving liens or interest for benefit of bankrupt estate, copies of which are attached hereto as exhibits A and B and by this reference made a part of this Petition.

III.

That the Findings of Fact signed by the Referee are in error in the following particulars:

a) The following facts as stated in Paragraph 3 of the Findings, "at which time the bankrupts had an equity of $85.00 therein", and, "have been set aside to the bankrupt to the extent of the excess in value thereof as found by the trustee over the unpaid balance due thereon reserving unto said trustee the right to preserve the interest of the vendor under said conditional sales contract [50] for the benefit of the bankrupt estate".

b) The facts set forth in Finding No. 4 as follows, "said sale became absolute as to the rights of the trustee in bankruptcy".

c) The Findings set forth in Paragraph 5 as follows, "it is proper that it be required to surrender the same to the trustee".

d) The Conclusion of Law set forth in full as follows,

"1. That said contracts of conditional sale should be declared absolute as to the rights of the trustee in bankruptcy, representing creditors subsequent in time to the execution of said contracts and the delivery of the property thereunder to the bankrupts, and that any lien or interest of the vendor, Sears Roebuck & Co., should be preserved for the benefit of the bankrupt estate."

IV.

The supplemental order referred to is in error in the following particulars:

a) In ordering, adjudging and decreeing that Sears, Roebuck & Company has no right, title, claim or interest in or to any of the personal property described in said conditional sales contracts, and said sales are absolute as to the rights of the trustees in bankruptcy.

b) In further ordering, adjudging and decreeing that all of the rights of said Sears, Roebuck & Company be and they are hereby preserved for the benefit of the bankrupt estate, and as a condition to retaining possession of said Kenmore sewing machine and Coldspot refrigerator the bankrupts

shall pay to the trustee the unpaid balance owing thereon, to-wit, the sum of $231.72, in the same manner as is prescribed in the original contract of conditional sale.

V.

The Referee should have determined his Order on the following legal principles:

a) That as to property set aside as exempt, the Trustee has [51] no interest in any vendor's interest of conditional sales contracts.

b) That the trustee can acquire no lien against personal property set aside as exempt.

c) That the trustee has no rights unless there is an actual creditor who has the power to avoid the transaction.

d) That where personal property set aside as exempt has a market valuation less than the exemptions allowed by state law, the trustee has no further right or claim against such property.

d) That as to property set aside as exempt, the trustee has no right to preserve the interest of a conditional sales vendor under conditional sales contracts for the benefit of the bankrupt estate.

Wherefore, Petitioner prays that the record be certified to the above entitled Court; that this review be considered and the Court enter its order reversing the order of the Referee and sending the

matter back for further consideration and action in accordance with the terms of this Petition.

PAINE, LOWE, COFFIN AND HERMAN,
/s/ By JOHN HUNEKE,
Attorneys for Sears, Roebuck & Company. [52]

Acknowledgment of Service Attached.

[Endorsed]: Filed May 23, 1958.

[Endorsed]: Certificate of Referee to Judge. Filed March 30, 1959.

United States District Court, Eastern District of Washington, Northern Division

In Bankruptcy No. B-10851

In the Matter of

CHARLES ROBERT BALDWIN and BETTY JUNE BALDWIN, his wife,
Bankrupts.

MEMORANDUM DECISION AND ORDER

This matter is before the court for review for the second time. Because of the conclusion I have reached as to the disposition I should make of the matter I have directed the clerk of the court to secure from the referee the remaining part of the

record of proceedings in the case which contains some of the documents before the court on the first review and I hereby direct the clerk of the court to file such proceedings as a part of the record in this proceedings, to be returned to the referee upon the conclusion of this review and any appeal that may be taken herein.

A brief review of the material facts in the case and a history of the proceedings as may be gleaned from the whole record will prove helpful is not essential.

Charles Robert Baldwin and his wife, Betty June Baldwin, as vendees, purchased from Sears, Roebuck & Co., as vendor, a sewing machine for the sum of $197 and a refrigerator for the sum of $211.95 under contracts of conditional sale. The contracts were not filed for record as required by the law of the State of Washington, R.C.W. 63.12.010.

Thereafter the Baldwins filed a voluntary petition in bankruptcy and were adjudicated bankrupts on February 21, 1957. In Schedule B-5 the bankrupts claimed as exempt personal property "Household furniture—furnishings, personal clothing in schedule B-2 (D) and New Standard Encyclopedia. [53] The above named property claimed to be exempt in accordance with the provisions of the Laws of the State of Washington, R.C.W. 6.16.010 et seq. $320.00".

The trustee's report of exempt property dated May 16, 1957 (approved by the Referee May 27,

1957) described the personal property allowed by law and claimed by bankrupts as follows:

> "Household furniture, furnishings, clothing and New Standard encyclopedia, Subject, however, to claim of lien of the Trustee arising out of preservation of chattel mortgage lien of Budget Finance Plan, and seller's interest in conditional sales contract of Sears-Roebuck RCW 6.16.010 et seq. 11 USCA § 24 (§6 Bankruptcy Act)"

In placing an estimated value on the property the trustee did not fix a dollar valuation thereon but apparently allowed what is described "equity" and under estimated value stated "to the extent of any excess over described liens."

On March 25, 1957, the referee upon petition of the trustee entered an order providing that Sears, Roebuck and Company had no right, title or claim in the personal property (refrigerator and sewing machine) described in the conditional sales contract and that the sale was an absolute sale as to the rights of the trustee in bankruptcy, and providing further that all the rights of Sears, Roebuck & Co. were preserved for the benefit and use of the bankrupt estate and as a condition of retaining possession of said personal property the bankrupts pay to the trustee the unpaid balance owing under the provisions of the conditional sales contract, to-wit: the sum of $231.72, in the same manner as provided in the original contract of conditional sale.

On May 27, 1957 Sears, Roebuck & Co. filed objections to the trustee's report of exempt property

and also a petition to review the referee's order above referred [54] to, wherein the company alleged:

> "That the order referred to is in error in the following particulars:
>
> "(a) The Referee failed to require the Trustee to itemize property to be set aside as exempt, particularly including the sewing machine and refrigerator referred to in the answer of this petitioner to the show cause order.
>
> "(b) The Referee failed to require that the trustee fix a market value of such items as of the date of bankruptcy and to fix such market value on each specific item, particularly the sewing machine and refrigerator.
>
> "(c) In declaring that Sears, Roebuck and Company had no right, title, or claim, or interest in or to such personal property, including the sewing machine and refrigerator.
>
> "(d) In ordering the terms of the conditional sale contract with Sears, Roebuck and Company to be enforced against the bankrupts."

The matter, along with four other cases wherein the referee made the same ruling under similar facts and circumstances, came on for review before the late Honorable Sam M. Driver, judge of this court.[1] Judge Driver, concluding that the five cases presented common questions, ruled upon the basic

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[1] It may be assumed from Judge Driver's letter-opinion that the facts and circumstances and rulings of the referee were substantially the same in all five cases.

issues presented in all the cases in a letter-opinion addressed to counsel in each of the said cases. The letter-opinion is as follows:

"December Tenth Yakima
1957

"Paine, Lowe, Coffin & Herman, 602 Spokane & Eastern Building, Spokane, Washington Attorneys for Sears, Roebuck & Co., and National Finance Corporation (B-2759, B-2961, B-10851, and B-10779)

"Velikanje, Velikanje & Moore, Miller Building, Yakima, Washington, Attorneys for Petitioners (B-2759) [55]

"Mr. Lloyd K. Miller, E. 7202-F Sprague Avenue, Spokane, Washington, Attorney for Petitioners (B-10991)

"Mr. William B. Iunker, 904 Paulsen Building, Spokane, Washington, Attorney for Beneficial Finance Corp. (B-10991)

"Mr. Joseph L. McDole, 418 Paulsen Building, Spokane, Washington, Attorney for Petitioners (B-10851)

"Mr. Charles T. Morbeck, 313 W. Kennewick Avenue, Kennewick, Washington, Attorney for Petitioner (B-2961)

"Mr. Edward V. Lockhart, Jr., Trustee (B-2759), Larson Building, Yakima, Washington

"Mr. Sidney Schulein, Trustee (B-10779, B-10851, B-10991), 708 Spokane & Eastern Bldg., Spokane, Washington

"Mr. Hugh B. Horton, Trustee (B-2961), Box 432, Kennewick, Washington

"Mr. Thomas Malott, 708 Spokane & Eastern Bldg., Spokane, Washington, Attorney for Trustee (B-2961)

"Dean & Williams, 219 Paulsen Building, Spokane, Washington, Attorneys for Bankrupt (B-10779)

"Mr. Arthur W. Kirschenmann, Larson Building, Yakima, Washington, Attorney for Trustee (B-2759)

"Gentlemen:

"Re:

In re Simmons, et ux, Bankrupts—B-2750 (So. Div.)

In re Brothwell, et ux., Bankrupts—B-2961 (So. Div.)

In re Carnegie, Bankrupt—B-10779 (No. Div.)

In re Baldwin, Bankrupt—B-10851 (No. Div.)

In re Bogle, et ux., Bankrupts—B-10991 (No. Div.)

"Although, as pointed out in the oral argument, there are procedural differences in the five above listed bankruptcy cases, they present common questions which I shall endeavor to pass upon in this letter covering all of them. [56]

"I have decided not to write a memorandum opinion for publication in Federal Supplement, as I think that in the public interest these cases—or at least one, or more, that are typical—should be appealed so that we may have an authoritative decision by the Court of Appeals for the Ninth Cir-

cuit. Since five of them have come up in the relatively small Eastern District of Washington within a short period of time, it seems logical to assume that a great number must arise in the Western District of this state, and in other large districts where the state statutory requirements are similar to those of Washington. In the event of appeal, any opinion that I might write, even if affirmance resulted, would be of very little authoritative value.

"Two of the questions involved here, I shall state by quoting from the certificate by the referee in the case of In re Simmons—No. B-2759, as follows:

> " '1. Where a bankrupt, prior to bankruptcy, purchased certain household equipment under conditional sale contracts which were never recorded as provided by State Statute and, in his bankruptcy Schedules the bankrupt claims the equipment as exempt, may the Trustee in Bankruptcy take over from the conditional sale vendor and preserve for the bankrupt estate the vendor's interest in the unrecorded contracts?'
>
> " '2. Under the same facts as above, may the conditional sale vendor compel the Trustee to set aside the bankrupt's claimed exemptions before the Trustee proceeds to take over and preserve the unrecorded conditional sale liens of the vendor?'

"As to question one, I shall sustain and affirm the holding of the referee to the effect that, the trustee succeeds to, and takes over, for the benefit

of the bankrupt estate, all of the right, title, and interest of a vendor under an unrecorded conditional sale. It follows, I think, that the trustee may, and should, take appropriate action to preserve the security and enforce the claim not only against the vendor but also against the bankrupt. All that the bankrupt gets on his claim of exemption is whatever value or interest there may be in the property over and above the unpaid balance of purchase price at the time of adjudication. In other words, I think the exemption of the bankrupt covers only what is commonly called 'the equity' in the property. He is not, as has been argued in the briefs, required to buy his exemptions, or to contribute after-acquired funds to the bankruptcy estate. If he considers the property of less value than the conditional sales claim against it, he need not make any payment at all, and the property will be taken over by the trustee. If he considers that he has a substantial interest or equity over and above the balance of the purchase price, then [57] he may pay and discharge the claim. His situation is comparable to what it would have been if the conditional sales contract had met all of the requirements of the applicable state statutes. His exemptions would be subject to the claim on the property of the conditional sales vendor.

"As to question number two, it may be, as held by the referee, that the conditional sales vendor is not in a position to compel the trustee to set aside the bankrupt's claimed exemptions. However, for

the sake of orderly and proper administration of bankrupt estates, over which I think I have general supervision, it is my view that where, in the circumstances of these cases, the bankrupt has claimed as exempt, either specifically or generally, the property covered by the unrecorded conditional sales contract, the trustee should perform his statutory duty, and should set apart the bankrupt's claimed exemptions, and report the items and estimated value thereof to the court, as directed by the bankruptcy act. Where the trustee has failed to perform his statutory duties in this regard, however, I think any sanctions imposed should be directed against the trustee rather than against the rights of the creditors of the estate. And, as indicated above, where the trustee acts as to exemptions in accordance with the provisions of the bankruptcy act, he should set apart to the bankrupt as exempt only the 'equity' in the property covered by the conditional sales contract; and, if the unpaid balance of the purchase price at the time of adjudication equals or exceeds the value of the property, there would be no value placed upon the exemption set apart. Otherwise, the value of the exemption would be the value of the property over and above the amount of unpaid balance under the conditional sales contract at the time of adjudication.

"Moreover, I think there is a very practical reason here for requiring the trustee to take statutory action with reference to claimed exemptions. In Sears, Roebuck & Co. v. McAllister, 184 F.2d 487,

the Ninth Circuit Court of Appeals declined to decide the principal question presented on appeal for the reason that the record did not show that the specific property involved, or any of it, had been set aside to the bankrupt, or was, in fact, exempt, and therefore the appellant conditional sales contract vendor had no ground for complaint. It seems to me that in each of the current cases the trustee's action as to exemptions should establish a posture for decision on the merits on appeal of the basic questions involved.

"There seems to be another question here — at least in one or more of the cases; namely, whether the conditional sales contract vendor should be required to pay over to the trustee payments made on [58] the contract by the bankrupt subsequent to adjudication. I do not believe that the vendor can be required to make such payment.

"My decision, and the reasons on which it is based, as stated above, apply with equal force to cases involving chattel mortgages which fail to meet the requirements of the Washington state statutes.

"If I have overlooked any question which should be decided in these cases, I trust you will bring it to my attention.

"I suggest that orders be drafted by the trustees in accordance with the views expressed herein. If difficulty is encountered in the drafting of the orders, or in getting agreement of opposing counsel as to the form of the order, I shall be available in

Spokane for several weeks beginning January 3, 1958.

"Yours very truly,

SAM M. DRIVER
United States District Judge

SMD/b
cc—Clerk, U. S. District Court
Referee in Bankruptcy"

Judge Driver, while ruling on the basic question involved, concluded that the trustee's report of exempt property in the cases was not made as required by the statute and remanded the cases with instructions to the referee that he should make or cause to be made a more detailed and adequate record as to the items of property claimed as exempt and thereafter appropriate findings, conclusions and order based thereon. The order in the case now before the court was as follows:

"It Is Now, Therefore, Ordered that this matter be remanded to the referee, who is hereby instructed to make or cause to be made a list of the items of property and the estimated values thereof claimed as exempt by the bankrupts, to set off such exemptions, or cause them to be set off, if such has not heretofore properly been done, and specifically to find whether the property covered by the above referred to conditional sales contracts constitute a part thereof; that the referee give notice of his proposed findings and conclusions as

aforesaid [59] to the attorneys for the trustee, the bankrupt, and Sears, Roebuck and Company, giving them an opportunity to be heard and object thereto. After the determination of the exempt property, the referee shall reconsider the order hereinabove mentioned involved in this review proceeding, making such changes therein as he deems appropriate as a result of the findings made and conclusions reached pertaining to the exempt property, and that such order as the referee may then make, or cause to be made, shall be subject to review in the same manner as any other order entered by the referee."

Thereafter a trustee's amended report of exempt property was made itemizing the household furnishings allowed as exempt, setting forth the estimated value of each item. With respect to the refrigerator an "equity" of $50 was reported with value of $200, and as to the sewing machine, an "equity" of $35 with value—$116.72. As to the last two items the following note appears on the report:

> "These two items, at the time the petition was filed, were being purchased from Sears Roebuck & Co. under conditional sales contracts, the lien of which the trustee reserves the right to preserve for the benefit of the bankrupt estate."

The total estimated value appearing on the report is $320. This is obviously in error, the correct total being $307.50 if the equity values are included and $539.72 if the equity values of the refrigerator and

sewing machine are excluded and the estimated value of the items used.

Following the filing of the amended report the referee, after a hearing at which Sears, Roebuck & Co. were represented by their attorneys, entered supplemental findings of fact, conclusion of law and order wherein after finding that the refrigerator and sewing machine, pursuant to the trustee's report on exemptions, had been set aside to the bankrupts to the extent of the excess in value over the unpaid balance due thereon, and that a signed memorandum of [60] conditional sale had not been filed as required by the statutes of the state of Washington, held as before that Sears, Roebuck & Co. had no right, title and interest in or to the refrigerator and sewing machine, that the sales were absolute as to the rights of the trustee, and that the rights of Sears, Roebuck & Co. should be preserved for the benefit of the bankrupt estate.

It thus appears that the same basic questions now before me for review were before Judge Driver in the earlier review and an examination of his letter-opinion makes it clear that Judge Driver sustained and affirmed the referee on the issues here presented. Further, it is reasonable to assume from a reading of the latter portion of the letter-opinion that the motivating purpose of Judge Driver in remanding the case to the referee was to correct and remedy a defective record with respect to the trustee's report on exemptions so as to permit an appellate review of his decision on the basic ques-

tion on the merits. Under the doctrine of "law of the case" a judge of coordinate jurisdiction should not overrule decisions of his associate based on the same set of facts, unless required by higher authority or unless it can be authoritatively concluded that the earlier decision was clearly erroneous. Standard Sewing Mach. Co. v. Leslie (7 Cir.) 118 Fed. 557; Luminous Unit Co. v. Freeman-Sweet Co. (7 Cir.) 3 F. 2d 577; United States v. Firman (W.D. Pa.) 98 F. Supp. 944; United States vs. Gas & Oil Development Co. (W.D. Wash.) 126 F. Supp. 840. I am not persuaded that Judge Driver's opinion is clearly erroneous and therefore it is incumbent upon me to affirm the order of the referee upon this review without going into the merits of the case. In so doing I believe it proper for me to state that in a memorandum opinion recently written by me in deciding a bankruptcy review [61] in the Western District of Washington, namely, In the Matter of Maynard Chris Espelund, etc., Bankrupt, No. 44906, I held invalid an order of the referee purporting to preserve for the benefit of the estate the lien of a chattel mortgage on property found to be exempt to the bankrupt and subrogating the trustee to the rights of the mortgagee. It may be that the reasoning in that opinion appears inconsistent with my decision in affirming the order of the referee herein. However, as already stated, my action here is based on the doctrine that the law of the case has already been established by a prior ruling of a judge of this court, not con-

trary to any higher authority and not clearly erroneous and should not be disturbed by me. The decision I made in the Espelund case I am informed is about to be appealed and may be reversed. I have been unable to find and I do not believe there are any appellate court decisions construing Section 70(e) of the Bankruptcy Act as applied in this and the Espelund case. Therefore, I cannot properly conclude that an interpretation contrary to my own views is clearly erroneous until the Court of Appeals for the Ninth Circuit or the Supreme Court of the United States decides the issue.

Further, while Judge Driver's letter-opinion states:

> "My decision, and the reasons on which it is based, as stated above, apply with equal force to cases involving chattel mortgages which fail to meet the requirements of the Washington state statutes."

the particular case before me does not involve a chattel mortgage, but a conditional sales contract. It should be noted that the exemption laws of the State of Washington, R.C.W. 6.16.020, provide, in part: [62]

> "* * * no property shall be exempt from an execution issued upon a judgment for the price thereof, or any part of the price thereof, * * *."

and Judge Neterer in the case of In re Phillips (W.D. of Wash.) 209 Fed. 490, held a debtor cannot claim an exemption as against an obligation

representing the purchase of the property claimed exempt.

The specific issue not being before me because of the basis of my decision I make no decision as to whether a bankrupt chattel mortgagee or mortgagor is in a different or more secure position when a claim of exemption is made on mortgaged personal property than a conditional sales vendee or vendor when a claim of exemption is made on personal property in the vendee's possession under conditional sales contract.

Having fully considered the matter and for the reasons and upon the grounds hereinabove set forth,

It Is Ordered that the supplemental order of the referee entered in these proceedings under date of May 13, 1958 be and the same is hereby affirmed.

Dated: August 21, 1959.

/s/ WILLIAM J. LINDBERG,
United States District Judge.

[Endorsed]: Filed August 21, 1959.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that Sears, Roebuck and Company, petitioner and appellant, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the order of the Honorable William J. Lindberg, entered August 21st, 1959, and from each and every part thereof.

Dated September 18, 1959.

/s/ JOHN HUNEKE,
PAINE, LOWE, COFFIN AND HERMAN,
WHEELER, McCUE & MORRIS,
Attorneys for Sears, Roebuck and Company. [64]

[Endorsed]: Filed September 18, 1959.

[Title of District Court and Cause.]

UNDERTAKING FOR COSTS ON APPEAL

Whereas, Sears, Roebuck and Company, a Corporation is about to appeal to the United States Circuit Court of Appeals for the Ninth Circuit of the United States of America, from an order made and entered in the District Court of the United States, Eastern District of Washington, Northern Division, on the 21st day of August, 1959, affirming the order of the Referee.

Now, Therefore, in consideration of the premises, and of such appeal, the undersigned, Anchor Casualty Company, a corporation duly organized and doing business under and by virtue of the laws of the State of Minnesota and duly licenced for the purpose of making, guaranteeing or becoming a surety upon bonds or undertakings required or authorized by the laws of the state of Washington, does hereby undertake and promise on the part of

Sears, Roebuck and Company, a Corporation, that the said Sears, Roebuck and Company, a Corporation will pay all costs which may be awarded against them on the appeal, or on a dismissal thereof not exceeding the sum of Two Hundred Fifty and No/ One Hundredths ($250.00) Dollars.

Signed, Sealed, and Dated This 16th day of September, 1959.

[Seal] ANCHOR CASUALTY COMPANY,
/s/ By W. A. KEYWORTH,
Attorney-in-Fact. [66]

Acknowledgment of Surety Attached. [65]

Certified Copy of Power of Attorney Attached.

[Endorsed]: Filed September 18, 1959.

[Title of District Court and Cause.]

APPELLANT'S STATEMENT OF POINTS

The points on which Sears, Roebuck and Company, as Appellant, will rely on the appeal are,

(1) The District Court erred in affirming the order of the referee in bankruptcy, declaring the unfiled conditional sales contracts covering the sale of a Coldspot refrigerator and a Kenmore sewing machine by Sears, Roebuck and Company to the bankrupts were absolute sales, when such items of

personal property were claimed as exempt by the bankrupts.

(2) The District Court erred in affirming the order of the referee in bankruptcy that Sears, Roebuck and Company, Petitioners, had no further right, title, or interest, in the Coldspot refrigerator and Kenmore sewing machine purchased by the bankrupts under unfiled conditional sales contracts and claimed as exempt by the bankrupts.

(3) The District Court erred in affirming the order of the referee in bankruptcy that, as to the Coldspot refrigerator and Kenmore sewing machine purchased from Sears, Roebuck and Company under unfiled conditional sales contracts and claimed as exempt by the bankrupts, the interest of Sears, Roebuck and Company could be preserved by the Trustee for the benefit of the bankrupts' estate, and the two items could be retained by the bankrupts on condition that the balance of the sales contracts [68] of Two Hundred and Thirty-One Dollars and Seventy-Two Cents ($231.72) be paid by the bankrupts into the bankrupts' estate.

/s/ JOHN HUNEKE,
Attorney for Sears, Roebuck and Co., Petitioners.

Acknowledgment of Service Attached. [69]

[Endorsed]: Filed October 20, 1959.

[Title of District Court and Cause.]

ORDER EXTENDING TIME FOR FILING RECORD AND DOCKETING APPEAL

On application of the Petitioner, Sears, Roebuck and Company ex parte, the court being fully advised, it is ordered that the time for filing the record on appeal with the United States Court of Appeals for the Ninth Circuit, and for docketing therein the appeal taken by Petitioner by notice of appeal filed September 18th, 1959, is extended to December 15, 1959, pursuant to Rule 73(g) of the Federal Rules of Civil Procedure.

Dated October 20th, 1959

/s/ CHARLES L. POWELL,
United States District Judge.

Notice of Mailing Attached. [70]

[Endorsed]: Filed October 20, 1959.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
Eastern District of Washington—ss.

I, B. W. Blake, Clerk of the United States District Court for the Eastern District of Washington, do hereby certify that the documents annexed

hereto are the original documents filed in the above-entitled cause, to wit:

Date Filed

2/21/57—Debtor's Petition.

2/25/57—Adjudication of Bankruptcy.

3/15/57—Petition to Declare Contract of Conditional Sale to be Absolute Sale.

3/25/57—Order Declaring Conditional Sale Contract of Sears, Roebuck and Company to be Absolute Sale.

4/19/57—Petition to Re-Open Show Cause Proceedings.

4/23/57—Order to Show Cause.

5/16/57—Answer to Petition to Declare Contract of Conditional Sale to be Absolute Sale.

5/16/57—Trustee's Report of Exempt Property.

5/27/57—Objections to Trustee's Report of Exempt Property.

5/27/57—Order Approving Trustee's Report of Exemptions.

5/27/57—Petition for Review.

10/16/57—Order Affirming Order Declaring Conditional Sale Contract of Sears, Roebuck and Company Absolute Sale.

16/16/57—Certificate by Referee to Judge.

10/29/57—Memorandum of Points and Authorities for Sears, Roebuck and Company.
Copy letter from Judge Driver dated 12/10/57.

Date Filed

2/28/58—Order on Petition for Review.

5/12/58—Order Approving Trustee's Amended Report of Exemptions.

3/30/59—Certificate of Referee to Judge (with attachments).

8/21/59—Memorandum Decision and Order.

9/18/59—Notice of Appeal.

9/18/59—Bond—Undertaking for Costs on Appeal.

10/20/59—Appellant's Statement of Points.

10/20/59—Order Extending Time for Filing Record and Docketing Appeal.

12/ 9/59—Appellant's Amended Designation of Record on Appeal.

and that the same constitute the record for hearing of the appeal from the Memorandum Decision and Order of the United States District Court for the Eastern District of Washington, in the United States Court of Appeals for the Ninth Circuit, as called for in Appellant's Amended Designation of Record on Appeal.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at Spokane in said District this 11th day of December, A.D. 1959.

[Seal] B. W. BLAKE,
Clerk.

[Title of District Court and Cause.]

ORDER DESIGNATING ATTORNEY TO SERVE FOR TRUSTEE

At Spokane, in said District, December 11, 1959.

It appearing to the Court that Sidney Schulein, trustee in bankruptcy in the above matter, has been wholly incapacitated since the 16 of September, 1959, by virtue of poliomyelitis, and that an appeal has been taken from an order entered herein to the Circuit Court of Appeals; it is

Ordered that Thomas Malott be and he is hereby designated as the attorney for the trustee on said appeal.

/s/ MICHAEL J. KERLEY,
Referee in Bankruptcy.

State of Washington,
County of Spokane—ss.

Thomas Malott, being first duly sworn, on his oath states:

That I am the attorney designated to serve as counsel for the trustee in the above proceeding; that I represent no interests adverse to those of the bankrupt estate and that I represent no persons having claims against the bankrupt estate; that I know of no reason why I should not serve as attorney for the trustee herein.

/s/ THOS. MALOTT.

Subscribed and sworn to before me this 11th day of December, 1959.

[Seal] /s/ GRAYCE M. NEWMAN,
Notary Public in and for the State of Washington, residing at Spokane. [73]

[Endorsed]: Filed December 11, 1959.

[Title of District Court and Cause.]

SUPPLEMENTAL CERTIFICATE OF CLERK

United States of America,
Eastern District of Washington—ss.

I, B. W. Blake, Clerk of the United States District Court for the Eastern District of Washington, do hereby certify that the document annexed hereto is the original document filed in the above-entitled cause on December 16, 1959, and submit it for consideration of the Court with the remainder of the record on appeal in this matter which was forwarded on the 11th day of December, 1959:

Title of Document

Order Designating Attorney to Serve for Trustee.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at Spokane in said District, this 16th day of December, 1959.

[Seal] /s/ B. W. BLAKE,
Clerk.

[Endorsed]: No. 16719. United States Court of Appeals for the Ninth Circuit. Sears, Roebuck & Company, a corporation, Appellant, vs. Sidney Schulein, Trustee in Bankruptcy of the Estate of Charles Robert Baldwin and Betty June Baldwin, bankrupts, Appellee. Transcript of Record. Appeal from the United States District Court for the Eastern District of Washington, Northern Division.

Filed: December 12, 1959.

Docketed: December 24, 1959.

Supplemental Filed December 18, 1959.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals
For The Ninth Circuit

No. 16719

SEARS, ROEBUCK & COMPANY,
Appellant,

vs.

SIDNEY SCHULEIN, Trustee, Respondent.

STATEMENT OF POINTS AND AUTHORITIES AND DESIGNATION OF RECORD BY APPELLANT

Comes now Sears, Roebuck & Company, Appellant in the above-entitled action, and for its Statement of Points and Designation of Record adopts the Appellant's Statement of Points appearing in the typed record and also Appellant's amended Designation of Record on Appeal appearing in the typed record.

/s/ JOHN HUNEKE,
Attorney for Appellant.

[Endorsed]: Filed December 24, 1959. Paul P. O'Brien, Clerk.

No. 16728

United States Court of Appeals
For the Ninth Circuit

McCRAY MARINE CONSTRUCTION COMPANY, *Appellant,*

vs.

UNITED STATES OF AMERICA, *Appellee.*

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLANT

R. STUART THOMSON
Attorney for Appellant.

6607 White-Henry-Stuart Building,
Seattle 1, Washington.

THE ARGUS PRESS, SEATTLE

No. 16728

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For the Ninth Circuit

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THE ARGUS PRESS, SEATTLE

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For the Ninth Circuit

McCray Marine Construction Company, *Appellant*,
vs.
United States of America, *Appellee*.
No. 16728

Appeal from the United States District Court for the Western District of Washington, Northern Division

BRIEF OF APPELLANT

JURISDICTION

This is an action based upon breach of contract against the United States of America for an amount less than $10,000, which is conferred upon a United States District Court by the provisions of Title 28 Section 1346, United States Code Annotated. The appellant, A. Walter McCray, is now and was at the time herein mentioned a resident of King County, Washington, doing business at Seattle, Washington, under the name and style of McCray Marine Construction Company.

A motion for summary judgment (R. 11) based upon a stipulation of the parties (R. 23) was filed herein October 8, 1959, upon the ground that plaintiff had failed to exhaust his administrative remedies and the court, accordingly, had no jurisdiction to try and determine the said matter.

After considering oral argument and written briefs, the court rendered an oral decision on October 21, 1959 (R. 11) granting defendant's motion for summary judgment of dismissal.

A written motion to reconsider supported by authorities (R. 15) was filed on October 27, 1959, by plaintiff.

The court signed and filed a memorandum opinion (R. 19) denying plaintiff's motion to reconsider on November 16, 1959.

On November 17, 1959, the court signed an order (R. 27) granting the defendant's motion for summary judgment and ordered the case dismissed with prejudice.

Notice of appeal (R. 28) from said order, together with bond on appeal (R. 29) was filed herein on November 19, 1959, and December 4, 1959, respectively.

Jurisdiction of this court on appeal is invoked under the Act of Congress dated June 25, 1948, Chap. 646, 62 Stat. 929, 28 United States Code Annotated Section 1291.

STATEMENT OF THE CASE

The appellant, also referred to as the Contractor, obtained a contract (Exhibit A) to repair seaplane ramps B an C at the United States Naval Air Station, Whidbey Island, Oak Harbor, Washington, from the United States Navy, hereafter referred to as the appellee or government, on March 28, 1957, for a consideration of $274,000.

Work was commenced in accordance with the contract and subsequently the appellant was delayed 15½ working days because certain substructure inspections had not been timely made by the appellee as required by the contract. The appellee was notified (Ex. B) that damages would result because of the delay from the first day that work was halted. A claim for $8,049.50 (Ex. C) was submitted after work had been resumed to the Resident Officer in Charge of Construction, United States Naval Air Station, Whidbey Island, and this claim was denied (Ex. D) on the grounds that the contract provisions did not allow for payment of such claims. The Officer in Charge of Construction, Thirteenth Naval District, Seattle, Washington, subsequently denied the claim (Ex. E, G) on the same ground. Finally the claim was submitted to the Contracting Officer, Bureau of Yards and Docks, Department of the Navy, Washington, D.C. (Ex. H). The appellant received a letter dated March 31, 1958, from the Contracting Officer (Ex. I) acknowledging receipt of the claim and stated:

> " * * * After careful review of the facts, the Contracting Officer determines that since your claim for increased costs is based upon Government-caused delays, it represents a claim for damages and as such cannot be the subject of compensation under the contract.
>
> "Accordingly, for the foregoing reason, your claim for additional compensation in the amount of $8,049.50 is hereby denied. This is a final decision of the Contracting Officer."

The appellant subsequently filed a complaint (R. 3)

against the appellee for the amount of the claim under the Tucker Act, based on a breach of contract caused by the unreasonable delay in making the inspection.

The appellee answered (R. 6) and alleged, amongst other things not pertinent here, that the court had no jurisdiction over the matter because the appellant had not exhausted his administrative remedies, specifically, in not appealing to the Secretary of the Navy within 30 days from the decision of the Contracting Officer as required by the disputes clause, Section 57 of the contract (Ex. A) relating to disputes of fact.

The jurisdictional question was raised by a motion for summary judgment (R. 11). The court, after considering written briefs and oral arguments, orally granted the appellee's motion for summary judgment (R. 11). A motion to reconsider (R. 15) was filed by the appellant which was denied, and subsequently the court signed the order (R. 27) granting appellee's motion for summary judgment and ordered the case dismissed with prejudice. The decision in this case will determine whether the appellant will have the claim considered on the merits.

SPECIFICATION OF ERROR

The District Court erred in granting appellee's motion for summary judgment and dismissing appellant's complaint.

SUMMARY OF ARGUMENT

I.

The final decision of the Contracting Officer, in a letter dated March 31, 1958 (Ex. I) denied the claim as a matter of law, therefore it was unnecessary to exhaust the administrative remedies, as required for disputes of fact, and relief could be obtained by filing the action directly in District Court. Even if one must exhaust administrative remedies in appealing conclusions of law made by a Contracting Officer, the 30-day period could not be invoked since such applies to decisions on disputes of fact under Section 57 of the contract.

II.

Even assuming that the Contracting Officer's final decision of March 31, 1958, was based on a question of fact and law or solely on a question of law, and that in either alternative, an exhaustion of administrative remedies was required, the claim was for unliquidated damages and as such was outside the jurisdiction of either the Contracting Officer or the Secretary of the Navy, and therefore within the jurisdiction of the appropriate District Court.

ARGUMENT OF THE CASE

I.

Section 57 of the contract (Ex. A), commonly referred to as the "disputes clause," is the section which must be carefully examined in considering this jurisdictional question. The pertinent portion of this clause reads as follows:

> " * * *, any dispute concerning a question of fact arising under this contract which is not disposed of by agreement shall be decided by the Chief of the Bureau of Yards and Docks, who shall reduce his decision to writing and mail or otherwise furnish a copy thereof to the Contractor. Within 30 days from the date of receipt of such copy, the Contractor may appeal by mailing or otherwise furnishing to the Chief of the Bureau of Yards and Docks a written appeal addressed to the Secretary, and the decision of the Secretary or his duly authorized representative for the hearing of such appeals shall, unless determined by a court of competent jurisdiction to have been fraudulent or capricious or arbitrary, or so grossly erroneous as necessarily to imply bad faith, or not supported by substantial evidence, be final and conclusive; provided that, if no such appeal is taken, the decision of the Chief of the Bureau of Yards and Docks shall be final and conclusive.* * *."

The above disputes clause applies only to questions of fact as distinguished from matters of law.

The Contracting Officer, in considering a claim presented by a Contractor, which the Contracting Officer is authorized to negotiate, has three alternatives. He may reach his decision based on (1) findings of fact (2) findings of fact and conclusions of law or (3) conclusions of law.

It is clear that an adverse finding of fact under the first alternative will require the Contractor to appeal the decision within 30 days to the Secretary of the Navy, whose decision will be final unless one of the exceptions recited in the disputes clause is encountered.

Ordinarily, the adverse decision of the Contracting Officer will be based on the first or third alternatives, so that the second alternative is mainly an academic question. No cases were found concerning a decision of a Contracting Officer based on both findings of fact and conclusions of law. Since the Contractor would be entitled to have any adverse ruling on a question of law ultimately decided by a court of competent jurisdiction, it would follow that the Contractor should not be required to exhaust his administrative remedies before going into a District Court for relief.

A decision by the Contracting Officer based solely on a matter of law under the third alternative above immediately raises two questions: (1) must the Contractor appeal the decision to the Secretary of the Navy and (2) within what time limit. Since the disputes clause only pertains to disputes involving questions of fact, it would appear that there is nothing in this which would require the Contractor to appeal an adverse holding on a question of law. Even assuming that the courts should still require that the administrative remedies be exhausted, aside from the disputes clause, since Section 57 only refers to questions of fact, the Contractor would not be bound by the 30-day period and could appeal the question of law within a reasonable time. 41 United States Code Annotated Section 322 provides:

> "No government contract shall contain a provision making final on a question of law the decision of any administrative official, representative or board."

Since a decision on the administrative level on a question of law is not final but subject to appeal to a District Court or the Court of Claims, it would appear unreasonable to require a Contractor to pursue such costly and time-consuming administrative steps before going into the appropriate court for relief. The mere fact that certain factual issues are subsequently raised in the court where the question of law is being determined, as in the instant case, should not be construed as a breakdown in the administrative process but rather a convenient action within which to settle all unresolved matters, both legal and factual. The courts have followed the above reasoning.

In *Allied Contractors v. United States,* 124 F. Supp. 366, 129 Ct. Cl. 400, the plaintiff entered into a construction contract with the Navy Department whereby plaintiff was to furnish the materials, labor and equipment necessary to perform the work of erecting antenna poles, transmission wire poles, access roads and other miscellaneous work.

The defendant did not follow the sequence of work as set forth in the specifications in that defendant failed to promptly remove the wire from the old poles. This delayed and disrupted the orderly progress of plaintiff's work, resulting in delay and expense to plaintiff.

The plaintiff requested payment by defendant for the extra costs incurred by reason of defendant's failure to follow the sequence of work set forth in the specifications, in the performance of the work required of defendant by the contract. The plaintiff's request for

$1,790 for extra costs on the antenna works is itemized in finding 15. The plaintiff's request for $2,406 was for the rental for the idle time of the caterpillar and roller, due to the failure of defendant to perform its part of the work under the contract, as it should and could have done within a reasonable time.

The defendant paid plaintiff the $1,790 requested for the antenna work by change order "C" dated June 21, 1949, which said in part: "Owing to the following change in the work, namely, revision in plans and procedure of construction by the Government, the contract price, in accordance with article 10 of the contract, is hereby increased by $1,790 * * *." The second item of extra costs of $2,506, the one for which plaintiff now seeks recovery, was denied by letter dated June 27, 1949, "on the grounds that it is in the nature of damages and therefore not compensable (administratively) under the contract."

Both claims were founded on defendant's failure to follow the sequence of work expressly set forth and called for in the specifications. Upon plaintiff's further request for payment it was subsequently denied again by a letter dated August 26, 1949, which stated:

> "In response to your oral inquiry, you are advised that the report from the Public Works Office at the Naval Academy does not indicate that the Government so modified your procedure under the subject contract as to cause additional costs and entitle you to additional compensation. Accordingly, there would appear to be no basis for reversing the Bureau's decision denying your claim for

$2,406 which was communicated to you by the Officer in Charge of Construction on June 27, 1949.

"This is a final decision of the Contracting Officer under Article 16 of the contract."

The plaintiff did not appeal this decision of the Contracting Officer.

The court said in commenting on the case:

"The defendant's other contention is that plaintiff did not exhaust his administrative remedies since it failed to appeal from the contracting officer's denial of its claim, and that decision is final and binding under *United States v. Blair,* 311 U.S. 730, 64 S.Ct. 820, 88 L.Ed. 1039. Under the facts in this case we do not agree. The contracting officer, or his duly authorized representative admitted a change in the plans and procedure of construction and by a change order "C" dated June 21, 1949, paid plaintiff $1,790 as part of the extra expense incurred by reason of such change. Plaintiff's protests were adequate. The remainder of plaintiff's claim amounting to $2,506 was denied by letter dated June 27, 1949, on the ground that it was a claim for unliquidated damages for breach of contract, notwithstanding the fact that both of plaintiff's claims for $1,790 and $2,506 were founded on defendant's failure to follow the sequence of work set forth in the specifications. The letter dated August 26, 1949, upon which defendant relies, refers to the June 27, 1949 letter and appears to be no more than an affirmation of that decision which clearly was not decided on a question of fact. No findings of fact were made by the contracting officer. Even if the August letter is considered by itself the most that can be said for defendant is that

it is ambiguous. Certainly if the contracting officer's decision is to be accorded finality it should be unequivocal and clear enough to appraise plaintiff of whether it was based on a question of fact or law so that plaintiff can reasonably determine whether an appeal is warranted. When the decision is ambiguous, as the August letter is, we must look to the surrounding circumstances to determine its meaning. In so doing we conclude that the contracting officer's decision was based on a question of law and, therefore, it was unnecessary for plaintiff to take an appeal therefrom. *Southeastern Oil Florida Inc. v. United States,* 127 Ct.Cl. 480; *Cramp Shipbuilding Co. v. United States,* 122 Ct. Cl. 72, 99; *Continental Illinois National Bank & Trust Co. v. United States,* 101 F.S. 755, 121 Ct. Cl. 203, 246; *Pottsville Casting & Machine Shops v. United States,* 101 F.S. 370, 121 Ct.Cll. 129; *Anthony P. Miller Inc. v. United States, supra.*" Certiorari denied, 75 S.Ct. 437, 348 U.S. 950.

The *Allied Contractors* case, *supra,* was followed more recently in *United States v. Adams,* 160 F.Supp. 143, where the District Court of Arkansas considered the question. The Contractor obtained a contract to manufacture wooden tent pins for the United States Army Quartermaster Department. The Contractor suffered certain losses on this contract because of unduly rigid inspection procedures practiced by a government inspector. In the meantime, the Contractor obtained another similar contract from a different Army Quartermaster Department. The Contractor was having some difficulty with its bank because of the loss being sustained on the first government contract. The Con-

tracting Officer handling the second contract wrote a letter to the Contractor notifying him that the second contract was being terminated because of the Contractor's default in that the Contractor was behind in his deliveries of tent pins and his company was in receivership under a mortgage foreclosure. The Contractor was also advised that if he was dissatisfied with the decision he could appeal to the Secretary of the Army in accordance with the disputes clause, however, the Contractor did not appeal from the decision of the Contracting Officer.

The principal questions of law involved in the case were passed upon by the court in connection with the disposition of a motion for summary judgment filed by the plaintiff. In passing on the motion for summary judgment, the court on June 8, 1957 wrote the attorneys for the parties a memorandum letter opinion giving the court's reasons for overruling the motion. In that letter the court made the following comments:

> "Gentlemen:
>
> "The briefs of the parties have been received, and plaintiff's motion for summary judgment is now ready for disposition. Plaintiff contends that the determination made by the Contracting Officer is final, particularly in view of the fact that defendant did not appeal to the Secretary of the Army. Defendant contends that the determination by the Contracting Officer is not final, and in any event that defendant has the right to show that the excess costs incurred by plaintiff was due to its own lack of diligence. The Court is of the opinion that plaintiff's motion for summary judgment must be

denied for two reasons: (1) the Contracting Officer's determination was one of law, and therefore not final; (2) even if the Contracting Officer's decision was final, defendant would be entitled to litigate the question of excess costs.

"It is now established that a decision of the head of any department or agency or his duly authorized representative in a dispute arising out of a contract entered into by the United States is not final if the decision is fraudulent, capricious, arbitrary, so grossly erroneous as to necessarily imply bad faith or is not supported by substantial evidence. 41 U.S.C.A. Sec. 321.

"41 U.S.C.A. Sec. 322 provides:

" 'No government contract shall contain a provision making final on a question of law the decision of any administrative official, representative or board.'

"These statutes were enacted to overcome the decision of the Supreme Court in *United States v. Wunderlich,* 342 U.S. 98, 72 S.Ct. 154, 96 L.Ed. 113, and to establish a uniform system of judicial review in such cases. *Valentine & Littleton v. United States,* 145 F.S. 952, 953, 136 Ct.Cl. 638. And the policy of the statutes should not be interpreted in a niggardly manner. *United States v. Lennox Metal Mfg. Co.,* 2nd Cir., 225 F.(2d) 302, 319; *United States v. T. W. Cunningham Inc.,* 141 F.S. 205, 207. However, the statutes were not intended to eliminate the necessity of contractors appealing decisions of contracting officers to the head of the department. See, Legislative News, p. 2196. As to questions of fact it is necessary for the contractors to appeal to the head of the department, unless the contracting officer makes it im-

possible for him to appeal as in the case of *United States v. Lennox Metal Mfg. Co.,* D.C. N.Y., 131 F.S. 717, 731, affirmed, 2 Cir., 225 F.(2d) 302. But as to questions of law, it is not always incumbent upon the contractor to appeal to the head of the department. See *Allied Contractors v. United States,* 124 F.S. 366, 129 Ct.Cl. 400, and cases therein cited. In the instant case, in the notice of termination the Contracting Officer, after stating that delivery of all of the pins had not been made stated: 'Inasmuch as your company is now in receivership under a mortgage foreclosure, it has been determined that you are unable to produce the balance due under the said contract. Therefore, it is the finding of the undersigned that your failure to deliver the balance of 253,900 each, Pins, within the time specified by the said contract is not due to causes beyond your control and without your fault or negligence within the meaning of General Provision 11 of the said contract, entitled "Default".'

"The only finding of fact made by the Contracting Officer was that defendant was in receivership under a mortgage foreclosure. The Contracting Officer then concluded as a matter of law that the failure of defendant to deliver the remaining pins was not due to causes beyond defendant's control and without fault or negligence within the meaning of the contract. The interpretation of the contract is a matter of law. *John A. Johnson Contracting Corp. v. United States,* 132 Ct.Cl. 645, 132 F.S. 698, 703. And, of course, the determination of whether defendant's failure was due to negligence is a matter of law. It follows that defendant is entitled to a judicial determination of this question * * *.

> "In view of the foregoing, an order is being entered today denying plaintiff's motion for summary judgment."

A similar matter was decided in *Halvorson v. United States,* 126 F.Supp. 898, 902 (D.C. Eastern District of Washington, Northern Division). The government plans, in that case, failed to provide shutters or protective coverings for ventilators in buildings being constructed for the government near Havre, Montana. Fine snow drifted through the openings into the attic area during construction and the Contractor was put to some extra expense in removing the snow, repairing and replacing damaged plastered walls and ceilings. The Contractor submitted a claim for additional expenses incurred to the resident engineer. It was denied because the official did not believe the contract provided for payment of such a claim. The contract required that all disputes concerning questions of fact must be decided by certain officials. The Contractor did not take any administrative appeal from the decision of the resident engineer or the Legal Division of the District Office. The court in that case said:

> "Moreover, the dispute on which the plaintiff's case was based, was not a dispute of fact or a dispute which involved the plans and specifications, but purely and simply a dispute on questions of law. The rejection letter mentions no factual dispute or issue, but, on the contrary, denies plaintiff's demand on a point of law, namely, that, as construed by the Legal Division of the District Office, plaintiffs were in effect insurers of the work until final acceptance by the United States * * *.

> "In the situation presented here, cases involving disputes clauses of government contracts, containing provisions that *all* disputes must be decided administratively, are not applicable. Where the disputes clause provides that disputes concerning questions of fact shall be decided by certain officers or agents of the government, and only questions of law involved, the contractor need not first exhaust his administrative remedies under the contract before instituting his court action."

How should the above decisions be applied to the questions raised in the instant case? The lower court said in its memorandum decision (R. 20):

> "While the *Allied Contractors* case may appear to support plaintiff's contention, it is my view that in so far as it does it is not in accord with the law as expressed by the Supreme Court in *United States v. Blair,* 321 U.S. 730, and *United States v. Holpuch Co.,* 328 U.S. 234."

First it should be pointed out that the *Blair* case was mentioned in the *Allied Contractors* case as being decisive where no appeal was taken from the Contracting Officer's decision but the Court of Claims held that under the facts it could not agree. The reason the *Blair* case was not followed in the *Allied Contractors* case nor should it be of any assistance in the case at hand, is because different versions of the disputes clause were being interpreted by the court. The disputes clause in *United States v. Blair,* 321 U.S. 730, reads as follows:

> "All disputes concerning questions arising under this contract shall be decided by the contracting officer or his duly authorized representative, subject to written appeal by the contractor within 30

> days to the head of the department concerned or his duly authorized representative, whose decision shall be final and conclusive upon the parties thereto as to such questions."

The significant feature of the above disputes clause is that it related to "all" disputes, whether involving questions of fact or law. Such a disputes clause is no longer legal since it would be contrary to 41 U.S.C.A. Sec. 322 which states that government contracts shall not include provisions making the decision of administrative officers final on questions of law. The *Blair* case, as well as the *Holpuch* case, can only be cited as authority for the rule that one must exhaust his administrative remedies where questions of fact are involved, as distinguished from questions of law, a proposition we are all agreed upon. Since the court in the *Allied Contractors* case was considering a disputes clause relating solely to disputes of fact, a clause exactly like the one found in the matter before this court, the case should be followed unless it has not been overruled by more recent cases emanating from the Court of Claims or the United States Supreme Court.

The lower court went further in its memorandum decision and said (R. 20):

> "Further, it would appear that the Court of Claims in its more recent decisions has failed to follow the pattern of the *Allied Contractors* case; see *Henry E. Wile Company v. United States,* 169 F.S. 249 at page 252."

The facts in the *Henry E. Wile* case, 169 F.Supp. 249, *supra,* were as follows: During the course of its work plaintiff encountered subsurface conditions dif-

ferent from those shown on the drawings or indicated in the specifications. Plaintiff, on September 29, 1953, under clause 4 of the contract, which is entitled "Changed Conditions," made a claim to the Contracting Officer for increased costs due to changed conditions. This claim was denied by the Contracting Officer on March 22, 1954, on the ground that plaintiff had not given proper notice and the alleged condition did not constitute a changed condition. The plaintiff failed to appeal this decision and the claim was ultimately dismissed for failure to exhaust the administrative remedies.

It is immediately apparent that the Contracting Officer denied the claim in his letter of March 22, 1954, on a question of fact. It then became necessary to appeal this factual ruling. The court in the *Henry E. Wile* case followed the well established rule that a contractor, governed by a "question of fact" disputes clause, must appeal from an adverse decision of a Contractor, governed by a "question of fact" disputes clause, must appeal from an adverse decision of a Contracting Officer on a question of fact, thereby exhausting his administrative remedies, before the claim may be considered by a District Court or the Court of Claims.

On the other hand, there were three holdings in the *Allied Contractors* case pertinent for our discussion here: (1) the denial of a claim "on the grounds that it is in the nature of damages and therefore not compensable (administratively) under the contract" is a decision based on a matter of law, (2) where it is not

clear whether a letter of the Contracting Officer in denying a claim is based on a question of fact or law, then the court can look to the surrounding circumstances in making that determination. The court, in the *Allied Contractors* case found the second letter of the government dated August 26, 1949, to be ambiguous, considered the surrounding facts and determined the claim was denied on a question of law. And (3) the Contractor is not required to appeal from the Contracting Officer's decision based on a question of law.

The appellant contends that the decision in the *Henry E. Wile* case did not alter the pattern set by the *Allied Contractors* case but only reiterated a rule which is not in controversy here.

Finally, the trial court distinguished the *Allied Contractors* case from the problems here presented (R. 20). The court referred to that portion of the *Allied Contractors* case (R. 21) which held that the surrounding circumstances could be considered where an ambiguous letter was involved. The court did not take the next mandatory step and find the Contracting Officer's letter of March 31, 1958, to be ambiguous, that the surrounding circumstances reveal it was one based on a question of fact and therefore an appeal was mandatory.

Instead the court said (R. 22):

> "A contractor cannot hold the contracting officer's letter up in the abstract. He has to consider the nature of his claim. And, as here, if the surrounding circumstances indicate that the decision is based on facts as well as law appeal would be

necessary. The opinion of the contracting officer that the issue involved was one of law rather than fact does not make it such."

The appellant finds the above language confusing and inconsistent with the usual credence given to the decision of the Contracting Officer in determining claims involving government contracts. His decision is the crossroads for all claims against the government. If based on a question of law then the road leads to the proper court, otherwise on to the next administrative level. The trial court suggests that the Contractor must consider the surrounding circumstances and not the written decision of the Contracting Officer, in determining whether an appeal is required. Such a conclusion would place a heavy burden on a contractor attempting to weave his path through the administrative process.

The March 31, 1958, letter (Ex. I) of the Contracting Officer started out, "After careful review of the facts, . . ." and then compared the claim with the provisions of the contract. The interpretation of the contract was the substance of the letter. The Contracting Officer might have used an opening phrase, "After thinking the matter over carefully" and the meaning of the letter wouldn't have been changed in any respect. The appellant is at a loss in attempting to find wherein the letter was ambiguous.

Assuming, for the sake of argument, that the decision of the Contracting Officer was ambiguous, which the appellant denies, at what point of time should these surrounding circumstances be considered by the Con-

tractor in deciding where to proceed with a claim rejected by the Contracting Officer? Surely it could only be those circumstances existing at the time of the Contracting Officer's decision or earlier. What happened at a later time could not possibly be timely in this regard.

An examination of the facts reveals that the first time the government contended there was no unreasonable delay in making the inspection appeared in appellee's answer (R. 7, 8) to appellant's complaint. The only other mention of inspection is found in the letter of denial signed by the Officer in Charge of Construction, Thirteenth Naval District, dated January 28, 1958 (Ex. G) where he said:

> "It is desired to point out that time was required to accomplish the inspection to be performed by the Government as specified in paragraph 3.6 of the contract. Further, upon completion of the inspection by the diver, time was required to analyze his report and determine what repairs were necessary. Obviously, the above referenced paragraph 3.6 of the specifications has informed the contractor that a delay will occur after the ramp decks have been removed."

There has never been any question but that it would take time to make the inspection and analyze the results of same and paragraph II of the Stipulation (R. 23) reveals that the parties estimated that it would take 3 or 4 days to accomplish the inspection.

The vital question is whether it was unreasonable for the government to start the inspection and then

terminate it for 18 days because of insufficient funds which ultimately required the Contractor to shut down for 15½ days. Since the government never raised this factual issue until they answered appellant's complaint, this was not one of the surrounding circumstances which the trial court could consider in determining whether an alleged ambiguous decision rendered by a Contracting Officer involved a question of fact or law.

In all of the earlier letters of denial, found in Exhibits D and G, the government denied the claim because there was no provision in the contract which allowed compensation for government-caused delays. The government never contended that these were reasonable government-caused delays until suit had been commenced. Obviously whether or not such damages are recoverable under the contract is a question of law. Therefore, even if the Contracting Officer's letter of March 31, 1958, was ambiguous, the surrounding circumstances indicate the claim was nevertheless being denied on a question of law.

II.

The appellant also contends that it was not necessary to appeal from the adverse decision of the Contracting Officer because it was a claim for unliquidated damages, and as such, would have been subject to a motion for dismissal by the government if the claim had been appealed and presented to the appropriate Board of Contract Appeals. Although the trial court did not mention this theory raised in appellant's motion to reconsider, nevertheless, the appellant believes it is as

equally persuasive as the other arguments mentioned above.

It should also be discussed if the appellate court should find that the district court did not have jurisdiction over the matter but that the 30-day period for appeal was not applicable, hence an appeal now to the Secretary of the Navy would still be possible. A holding by the Board of Contract Appeals that it involved a claim for unliquidated damages over which they had no jurisdiction would leave the appellant without an administrative body or court from which to obtain relief.

In *Railroad Waterproofing Corp. v. United States,* 133 Ct.Cls. 911, 137 F.Supp. 713, the Contractor obtained a contract to do certain work based on erroneous government specifications. When the error was noticed the government agent requested that the additional work be done and the job was continued to completion. The Contractor subsequently submitted a claim to the Contracting Officer for extra work. The Contracting Officer made certain purported findings of fact and a decision rejecting plaintiff's claim. The court said:

> "The findings of fact and decision appear to have been a decision based solely on legal considerations. They recited the terms of the contract documents, found that no extra work, materials or changes had been ordered by the Contracting Officer, stated that any work performed by the contractor in variance with or in addition to the contract was performed at its own risk and without order from the Contracting Officer, and decided

> that no amount was due the plaintiff over and above the unpaid balance of the contract price. The Contracting Officer failed to make any findings as to the extra work plaintiff had to do on account of the lineal measurements. The covering letter for Mr. Stone's finding of fact and decision called attention to the 'Disputes' clause of the contract and advised that any appeal should be made to the Board of Contract Appeals."

The Contractor failed to appeal the decision within 30 days as required by the disputes clause for questions of fact. The government raised the point that the Contractor was precluded from seeking relief in this court because it has not exhausted its remedies under the disputes clause of the contract and referred to the 30-day requirement. The court commented again:

> "Were this a matter over which the Contracting Officer or the Secretary of War had authority, we might agree with defendant's contention. But the claim is one for unliquidated damages. Over such claims the executive departments decline to exercise jurisdiction on the ground that they are not within their authority. *Continental Illinois National Bank v. United States,* 101 F.S. 755, 121 Ct.Cl. 203; *Pottsville Casting & Machine Shop v. United States,* 101 F.S. 370, 121 Ct.Cl. 129; *Anthony P. Miller v. United States,* 77 F.S. 209, 111 Ct.Cl. 252. Since the Contracting Officer had no authority to decide a claim of this kind it was not necessary to appeal from his decision. *Pottsville Casting & Machine Shops v. United States, supra; Anthony P. Miller v. United States, supra;* see also *Allied Contractors Inc. v. United States,* 124 F.S. 366, 129 Ct.Cl. 400."

This matter had been discussed earlier in the case of *Langevin v. United States,* 100 Ct.Cls. 15, 30, where the court said:

> "Congress has conferred exclusive jurisdiction on this court, and in certain cases on the district courts, to decide claims against the Government. It has consented to be sued only in these forums. Can, then, some agent of the Government other than Congress validly contract that someone other than this court or a district court may finally determine the facts upon which liability of the defendants rests? Ordinarily, when the facts are once found, the case has been nine-tenths decided. Since Congress has vested in this court and in the district courts exclusive jurisdiction of cases against the Government, it is not to be presumed that the parties intended that some other tribunal should make findings of fact that would be binding on us. If they did, their agreement would be in violation of the Act of Congress vesting jurisdiction in this court and the district courts, and therefore void.
>
> "We have consistently held that neither article 9 nor article 15 of the Standard Government Contract gives the contracting officer the power to determine a contractor's claim for damages for delay. See *Phoenix Bridge Co. v. United States,* 85 Ct.Cls. 603, 629, and *Plato v. United States,* 86 Ct. Cls. 665, 677. See also *United States v. Rice and Burton, Receivers,* 317 U.S. 61, 67.
>
> "In a suit against the United States for damages for delay, we do not think the contracting officer's findings of fact on the cause or extent of delay are conclusive."

An example of what might have happened to the ap-

pellant's claim even if it had been appealed to the Board of Contract Appeals is found in Paragraph 1972—*Gustave Hirsch Organizations, Inc.,* which was a hearing before the Board of Contract Appeals, cited 58-2 BCA, October 30, 1958.

The appellant filed an appeal from a letter decision of the Contracting Officer which dismissed five claims for additional compensation as being claims for unliquidated damages, based upon alleged delays by the government in meeting its obligations under the contract, which he had no authority to entertain and settle under the terms of the contract.

There was some discussion over the fact that the appellant hadn't appealed within the 30 days as required by the disputes clause but then the Board went on to say:

> "It seems to the Board that the motion to dismiss for lack of jurisdiction should be granted in the instant case, although not on the ground advanced by the Government. Paragraph 23 of the Special Conditions of the specifications provided that certain materials described therein would be furnished by the Government for use by the contractor in performance of work under the contract, and set forth an 'estimated delivery date' for most of the categories of materials described. Other provisions of the specifications provided for the furnishing or approval by the Department of drawings for use by the contractor in performing the contract work. The instant claims, which are based solely on the alleged unreasonable or otherwise improper delays of the Government in furnishing certain of the materials and drawings, would not,

if proven, come within the purview of any of the contract provisions, such as the 'changes' and 'changed conditions' clauses, that permit the allowance of equitable adjustments in the contract price by administrative action, but would amount to claims for damages for breach of contract. It is well settled that claims of this type are beyond the jurisdiction of either the contracting officer or the Board to consider and settle such a contract as the present. * * * This is the only valid reason, however, for the Board's lack of jurisdiction. The scope of the 'disputes' clause is limited by its own terms to disputes 'concerning a question of fact arising under this contract.' In the appeal of D. R. Haddox, IBCA-84 (July 19, 1957) the Board held that an appeal relating to a matter outside the 'disputes' clause was not subject to the 30 day limitation and the rationale of that decision is equally applicable to cases involving only questions of law. The question presented in the instant case, is, of course, one of law."

The court's attention is directed to the letter of the Officer in Charge of Construction, Thirteenth Naval District, dated January 28, 1958 (Exhibit G), wherein he said:

"In the absence of a contract provision which would enable the Contracting Officer to make an adjustment in contract price because of delays occasioned by the Government, and for standby and other additional costs incurred as a result thereof, the Officer in Charge of Construction is not given authority to make such an adjustment in the contract price."

Such a statement indicates the government didn't

believe the claim could be settled administratively. See also *Torres v. United States,* 126 Ct.Cls. 76; *Ross and Co. v. United States,* 126 Ct.Cls. 323, 112 F.Supp. 363; *F. H. McGraw & Co. v. United States,* 131 Ct.Cls. 29, 130 F.Supp. 394; *Silberblatt & Lasker Inc. v. United States*, 101 Ct.Cls. 54, 80.

United States Army and Air Force construction contracts contain a "Suspension of Work" clause under which a suspension of work of unreasonable duration becomes the basis of a claim arising under the contract, and this clause has been interpreted to cover, not only cases where the contractor has been ordered to stop work, but also cases where the contractor is forced to stop work as a result of acts or omissions of the Government. Navy construction contracts do not contain such a clause, and as a result, Navy construction contractors, such as appellant, must still sue in the Court of Claims or district courts to recover damages for unreasonable delays caused by the Navy on construction projects.

CONCLUSION

The decision of the Contracting Officer in his letter of March 31, 1958, was based on a question of law, therefore, an appeal was unnecessary and appellant was entitled to have the matter heard in an appropriate district court.

Even though an appeal is held to be required from an adverse ruling on a question of law, the 30 day period relating to questions of fact is not applicable and

an appeal may still be taken to the Secretary of the Navy within a reasonable time.

Although the Contracting Officer's written decision may have been ambiguous, the surrounding circumstances still indicate the decision was based on a question of law.

In any event, the claim was one for unliquidated damages and outside the authority of the Contracting Officer or other executive officers, and therefore a proper subject of jurisdiction for a United States District Court to entertain.

Respectfully submitted,

R. Stuart Thomson
Attorney for Appellant.

No. 16728

United States Court of Appeals

for the Ninth Circuit

McCRAY MARINE CONSTRUCTION COMPANY,

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vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the Western District of Washington, Northern Division.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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In the District Court of the United States for the Western District of Washington, Northern Division

Civil Action No. 4686

McCRAY MARINE CONSTRUCTION CO.,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

Comes Now the plaintiff and alleges as follows:

I.

That A. Walter McCray is now and was at the time herein mentioned a resident of King County doing business at Seattle under the name and style of McCray Marine Construction Company. That jurisdiction for this breach of contract action, for an amount less than $10,000, is conferred upon the above-entitled court by the provisions of Title 28, Section 1346 United States Code Annotated.

II.

That the McCray Marine Construction Co., hereafter referred to as the Contractor, entered into a contract on March 28, 1957 with the United States of America, hereafter referred to as the Government, to repair seaplane ramps "B" and "C" at the United States Naval Air Station, Whidbey Island, Oak Harbor, Washington, for a considera-

tion of $274,000, a copy of said contract being in the hands of the Government.

III.

That unnecessary delays caused by the Government are provided for in Section 9 (b) of the Standard Construction Contract as follows: "* * * All inspection and tests by the Government shall be performed in such manner as not unnecessarily to delay the work * * *" The only other part of the contract referring to delays is Section 5(c) and it provides only for an extension of time and no liquidated damage charges where the Contractor has been delayed for a number of causes, Section 5(c) providing as follows:

"The right of the Contractor to proceed shall not be terminated, as provided in paragraph (a) hereof, nor the Contractor charged with liquidated or actual damages, as provided in paragraph (b) hereof because of any delays in the completion of the work due to unforeseeable causes beyond the control and without fault or negligence of the Contractor, including, but not restricted to, acts of God, or of the public enemy, acts of the Government, in either its sovereign or contractual capacity, acts of another contractor in the performance of a contract with the Government, fires, floods, epidemics, quarantine restrictions, strikes, freight embargoes, and unusually severe weather, or delays of subcontractors or suppliers due to such causes: Provided, that the Contractor shall within 10 days from the beginning of any such delay, unless the

Contracting Officer shall grant a further period of time prior to the date of final settlement of the contract, notify the Contracting Officer in writing of the causes of delay. The Contract Officer shall ascertain the facts and the extent of the delay and extend the time for completing the work when in his judgment the findings of fact justify such an extension, and his findings of fact thereon shall be final and conclusive on the parties hereto, subject only to appeal as provided in Clause 6 hereof."

IV.

That the Contractor commenced the repair work and by July 3, 1957, the composite wood and concrete slabs had been removed from seaplane ramp "B" and a letter was sent to the Government on July 3, 1957, advising them that ramp "B" was ready for inspection in accordance with Specifications 6639/56, page 19, paragraph 3.6 which reads as follows: "* * * Immediately following the removal of the existing composite slabs, the Government will perform an inspection of the substructures and will determine the locations of the new pile caps * * *" The repair work continued and by July 22, 1957, the composite wood and concrete slabs had been removed from seaplane ramp "C" and the Government was advised on July 22, 1957, by letter that ramp "C" was ready for inspection in accordance with the above-mentioned Specifications. On July 23, 1957, the Contractor advised the Government by letter that men and equipment would

be standing idly by after July 24, 1957, until either ramp "B" or "C" had been inspected. Due solely to the negligence of the Government the inspections were not made and the men and equipment were idle for sixteen (16) working days between July 25 and August 15, 1957, before the Contractor was able to resume working and eventually complete the repair work.

V.

That said Government was duly notified that damages had been incurred by the Contractor because of such delays but it has neglected to pay for the same or any part thereof.

VI.

Wherefore, the plaintiff prays for judgment against defendant in the sum of $8,049.50 with interest thereon from August 15, 1957, and costs.

/s/ R. STUART THOMSON,
Attorney for Plaintiff.

Duly verified.

[Endorsed]: Filed September 26, 1958.

[Title of District Court and Cause.]

ANSWER

Comes now the defendant, United States of America, represented by Charles P. Moriarty, United States Attorney for the Western District of Washington and George S. Lundin, Assistant United States Attorney for said district and answers plain-

tiff's complaint by admitting and denying and alleging as follows:

I.

Defendant denies knowledge or information sufficient to form a belief as to the allegations of the first sentence of plaintiff's complaint and denies the remainder of said paragraph.

II.

Defendant admits paragraph II of plaintiff's complaint.

III.

Defendant admits that the language quoted by plaintiff in paragraph III of the complaint appears in the contract in question; defendant denies the remainder of said paragraph.

IV.

Defendant admits that work was commenced as alleged in paragraph IV of plaintiff's complaint, that letters from the plaintiff were received indicating that ramps "B" and "C" would be available for inspection on 8 July, 1957, and 24 July, 1957, respectively and that the plaintiff's letter of 23 July, 1957, was received. Defendant denies plaintiff's allegation that there was any negligence of defendant or others in making required inspections. Defendant affirmatively alleges that plaintiff failed to abide by the work schedule which was furnished by plaintiff to defendant on or about 10 April, 1957, in accordance with Section 44 of the contract under which plaintiff has commenced his action and Sec-

tion 1.21 of the contract specifications. Defendant asserts that such failure of plaintiff to abide by said work schedule caused plaintiff's damages, if any.

Defendant further avers that inspection of the sub-structure of ramps "B" and "C" was accomplished with all due diligence after plaintiff had advised work was not being performed according to schedule by plaintiff. Defendant asserts that certain delays are inherent in underwater inspection and should have been foreseen by plaintiff.

V.

Defendant admits that it was notified of alleged damages incurred by plaintiff and that it has not paid for same. Defendant denies responsibility for plaintiff's delays and avers that plaintiff's damages, if any, were due to fault of plaintiff.

VI.

Defendant denies the entitlement of plaintiff to any and all amounts alleged in paragraph VI of the complaint.

VII.

As a First Affirmative Defense, Defendant alleges as follows:

That Section 57 of contract under which plaintiff is bringing his action reads in pertinent part as follows:

"Except as otherwise provided in this contract, any dispute concerning a question of fact arising

under this contract which is not disposed of by agreement shall be decided by the Chief of the Bureau of Yards and Docks, who shall reduce his decision to writing and mail or otherwise furnish a copy thereof to the Contractor. Within 30 days from the date of receipt of such copy, the Contractor may appeal by mailing or otherwise furnishing to the Chief of the Bureau of Yards and Docks a written appeal addressed to the Secretary, and the decision of the Secretary or his duly authorized representative for the hearing of such appeals shall, unless determined by a court of competent jurisdiction to have been fraudulent or capricious or arbitrary, or so grossly erroneous as necessarily to imply bad faith, or not supported by substantial evidence, be final and conclusive; provided that, if no such appeal is taken, the decision of the Chief of the Bureau of Yards and Docks shall be final and conclusive. In connection with any appeal proceeding under this clause, the Contractor shall be afforded an opportunity to be heard and to offer evidence in support of its appeal. Pending final decision of a dispute hereunder, the Contractor shall proceed diligently with the performance of the contract and in accordance with the decision of the Chief of the Bureau of Yards and Docks. The term "Chief of the Bureau of Yards and Docks" as used herein shall include his duly appointed successor or his representative specially designated for this purpose." * * *

VIII.

That this case involves a question of fact which

should properly be considered administratively under Section 57 of the Contract in question, first by Chief of the Bureau of Yards and Docks (Navy Department) and thereafter on appeal, if any there be, by the Secretary of the Navy or his duly authorized representative for hearing of such appeals.

IX.

That plaintiff has failed to abide by the section of the contract in question set out above in paragraph VII and has failed to pursue his administrative remedies which he must do under the contract prior to commencing this action, that he is entitled to no relief in this action.

X.

As a Second Affirmative Defense, Defendant realleges paragraphs VII, VIII and IX of his answer and asserts that this Court has jurisdiction over neither the defendant nor this cause of action.

Wherefore defendant prays that plaintiff's complaint be dismissed with prejudice and that defendant have its cost herein.

/s/ CHARLES P. MORIARTY,
United States Attorney;

/s/ GEORGE S. LUNDIN,
Assistant U. S. Attorney.

Certificate of service attached.

[Endorsed]: Filed January 15, 1959.

[Title of District Court and Cause.]

MOTION FOR SUMMARY JUDGMENT

Defendant moves the above-entitled court to enter summary judgment for the defendant in the above-entitled case because plaintiff has failed to exhaust his administrative remedies and this court, accordingly, has no jurisdiction to try and determine the said matter. Defendant's motion is based upon pleadings in the case to date, the stipulation of the parties filed herein and the memorandum of authorities filed with this motion.

/s/ CHARLES P. MORIARTY,
United States Attorney;

/s/ GEORGE S. LUNDIN,
Assistant U. S. Attorney.

Receipt of copy acknowledged.

[Endorsed]: Filed October 8, 1959.

[Title of District Court and Cause.]

ORAL DECISION

Transcript of Oral Decision by the Honorable William J. Lindberg, a United States District Judge, upon motion of defendant for summary judgment in the above-entitled and numbered cause,

on the 21st day of October, 1959, at Seattle, Washington.

Appearances:

R. STUART THOMSON,
Appeared for and on behalf of the Plaintiff; and

GEORGE S. LUNDIN,
Assistant United States Attorney, Western District of Washington,
Appeared for and on behalf of the Defendant.

Whereupon, the following proceedings were had, to wit:

Proceedings

(Whereupon, argument for and on behalf of the respective parties on motion of defendant for summary judgment having been made by their respective counsel, the following proceedings were then had, to wit:)

The Court: Well, gentlemen, I have examined this, as I say, and your briefs and also the exhibits pretty carefully and I feel I can decide the matter now by virtue of your stipulation and it seems to me the facts as stipulated are as they appear in the file and are without dispute so that there is apparently no dispute as to a material factual issue with respect to the question of jurisdiction.

Now, as I view it here the claim made upon the government under the complaint for damages is based upon an alleged breach of contract involving issues which are of a factual nature. Granting that an issue of law may also arise, the interpretation of the contract resolving such issue cannot be ascertained or a decision of that issue cannot be reached without determining an issue of fact.

With respect to the issue of delay, it is alleged that and agreed that the plaintiff bases its claim upon the failure of the government to timely inspect the pilings and other area after the ramp had been removed; that is, within a reasonable time. The time or days of delay, of course, are agreed.

Now, whether that delay was an unnecessary one or an unreasonable one I do not believe can be decided as a question of law without resolving the factual issues. Further, whether or not damage resulted to the plaintiff from such delay also involved a factual issue.

It is my conclusion that under the provisions of the dispute clause, namely section 57, those factual issues must be presented and determined not only by the contracting officer but also, if adverse to claimant, an appeal from such decision, even if made without considering the facts or making a factual finding, must be prosecuted. That admittedly was not done and under the terms of the dispute clause the plaintiff is foreclosed.

Therefore, I feel that the court must grant the motion for summary judgment.

I do so somewhat reluctantly because I feel in

some of these cases at least the contractors are foreclosed from possible relief because they may not have been fully aware of the obligation upon them to avail themselves of the administrative remedies, but that is the result of the fact that although the government has permitted the suing of itself it still retains, under the old principle, the rights of a sovereign and when Congress grants the right it grants it with conditions and those who sue the government must comply with the requirements before they may prevail in an action in court.

Therefore, the court will grant the motion.

I don't think it is necessary to make findings of fact in this case. I think, however, that the order should recite the grounds upon which it is granted.

Mr. Lundin: Yes, your Honor.

Mr. Thompson: Yes, your Honor, I think that is a good idea.

The Court: Very well. The court will recess until tomorrow morning at ten o'clock.

(Whereupon, at 3:28 o'clock p.m., October 21, 1959, hearing in the within-entitled and numbered cause was adjourned.)

Reporter's Certificate

I, Earl V. Halvorson, official court reporter for the United States District Court for the Eastern and Western Districts of Washington, do hereby certify that the foregoing is a true and correct transcript of an extract of proceedings had in the within-entitled and numbered cause on the date herein-

before set forth; and I do further certify that the foregoing transcript has been prepared by me or under my direction.

/s/ EARL V. HALVORSON.

[Endorsed]: Filed October 22, 1959.

[Title of District Court and Cause.]

MOTION FOR RECONSIDERATION AND FOR ORDER DENYING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT NOT WITHSTANDING COURT'S ORAL DECISION

Plaintiff moves for reconsideration of the court's oral decision in favor of defendant on the motion for summary judgment and in support of its motion submits the following:

The motion in the above-entitled action ultimately turned on the question of whether the Contracting Officer, in his letter of March 31, 1958, denied the claim solely as a matter of law or as a mixed question of law and fact. It was the opinion of the court that a mixed question of law and fact was involved. It is the contention of the plaintiff that the letter of March 31, 1958, only recited a conclusion of law, that there were no findings of fact hence the plaintiff could take the matter directly into District Court. The reasonableness or unreasonableness of the delay is not before the court at this time but

would be resolved after the motion for summary judgment has been settled. It seems very clear that where a Contracting Officer has denied a claims as a matter of law and left certain factual problems unsettled that the plaintiff would be required to continue to exhaust his administrative remedies, if he could ascertain what findings of fact the Government was making, and then much later return to the District Court to have the matter of law settled, as the court would suggest in this case.

The following cases were cited in plaintiff's trial brief or at the bottom of his supplement to plaintiff's trial brief. It is believed the cases are so decisive upon the question upon which the case turned that the court should have them fully briefed. The granting of the motion for summary judgment will be in conflict with the holdings of these cases and in particular with the case of Allied Contractors vs. United States, infra.

* * *

There is another reason why the United States District Court has jurisdiction over this case. The claim is for unliquidated damages caused by a breach of contract. Such a claim would have been subject to a motion for dismissal even if an appeal had been taken from the decision of the Contracting Officer. In an article in the Practical Lawyer (Published by the joint American Law Institute-American Bar Association Committee on Continuing Legal Education) Vol. 4-No. 6, October, 1958, entitled

"How To Deal With The Navy In The Field Of Business Law" p. 50 it is said:

"Thus, of the two kinds of claims possible under government contracts, those arising under the contract must by virtue of the Disputes clause, be presented to the contracting officer, and on appeal to the ASBCA (Armed Services Board of Contract Appeals). Claims for breach of contract may not be determined by the contracting officer or the ASBCA and can be allowed only by the Court of Claims, or, if for less than $10,000, by an appropriate District Court. The two kinds of claims are mutually exclusive: claims arising under the contract can be determined only within the Department of Defense, and claims for breach of it can be determined only by tribunals outside the Department."

To illustrate this matter attention is directed to Paragraph 1972—Gustav Hirsch Organization, Inc., which was a hearing before the Board of Contract Appeals, cited 58-2 BCA, October 30, 1958.

The appellant filed an appeal from a letter decision of the contracting officer which dismissed five claims for additional compensation as being claims for unliquidated damages, based upon alleged delays by the Government in meeting its obligations under the contract, which he had no authority to entertain and settle under the terms of the contract.

There was some discussion over the fact that the appellant hadn't appealed within 30 days as required by the disputes clause but then the Board went on to say:

"It seems to the Board that the motion to dismiss

for lack of jurisdiction should be granted in the instant case, although not on the ground advanced by the Government. Paragraph 23 of the Special Conditions of the specifications provided that certain materials described therein would be furnished by the Government for use by the contractor in performance of work under the contract, and set forth an 'estimated delivery date' for most of the categories of materials described. Other provisions of the specifications provided for the furnishing or approval by the Department of drawings for use by the contractor in performing the contract work. The instant claims, which are based solely on the alleged unreasonable or otherwise improper delays of the Government in furnishing certain of the materials and drawings, would not, if proven, come within the purview of any of the contract provisions, such as the "changes" and "changed conditions" clauses, that permit the allowance of equitable adjustments in the contract price by administrative action, but would amount to claims for damages for breach of contract. It is well settled that claims of this type are beyond he jurisdiction of either the contracting officer or the Board to consider and settle such a contract as the present (cases cited). This is the only valid reason, however, for the Board's lack of jurisdiction. The scope of the 'disputes' clause is limited by its own terms to disputes 'concering a question of facts arising under this contract.' In the appeal of D. R. Haddox, IBCA-84 (July 19, 1957), the Board held that an appeal relating to a matter outside the 'disputes' clause was not subject to the 30

day limitation and the rationale of that decision is equally applicable to cases involving only questions of law. The question presented in the instant case, is, of course, one of law."

The courts attention is directed to Exhibits "C," "G" and "I."

Respectfully submitted,

/s/ R. STUART THOMSON,
Attorney for Plaintiff.

Receipt of copy acknowledged.

[Endorsed]: Filed October 27, 1959.

[Title of District Court and Cause.]

MEMORANDUM OPINION DENYING PLAINTIFF'S MOTION FOR RECONSIDERATION

Plaintiff has moved for reconsideration of the court's oral decision granting defendant's motion for summary judgment.

It is the contention of plaintiff that the letter of the contracting officer under date of March 31, 1958, Exhibit 1, only recited a conclusion of law without findings of fact of any kind and that therefore the plaintiff need not appeal the decision as provided in the disputes clause but may immediately seek relief in the district court.

Plaintiff relies primarily on the case of Allied Contractors vs. United States, 124 F. Supp. 366, although other cases are cited. While the Allied Contractors case may appear to support plaintiff's contention, it is my view that in so far as it does it is not in accord with the law as expressed by the Supreme Court in United States vs. Blair, 321 U.S. 730 and United States vs. Holpuch Co., 328 U.S. 234. Further, it would appear that the Court of Claims in its more recent decisions has failed to follow the pattern of the Allied Contractors case; see Henry E. Wile Company vs. United States, 169 F. Supp. 249 at page 252.

Also a careful study of the Allied Contractors case clearly indicates that it is distinguishable from the problem here presented. There, plaintiff had a contract with the government which admittedly required the government to follow a certain sequence with respect to its part in the contract. The government failed to follow that sequence and as a result (1) it took plaintiff additional time to complete the work required, and (2) plaintiff had to keep rented equipment idle. Plaintiff put in two claims as stated. The first was granted and the second denied for the reason that the claim amounted to a claim for damages for breach of contract (not cognizable administratively). Both claims were based upon the same undisputed fact. See page 368:

> "The defendant concedes * * * that defendant did not follow the sequence of work as set forth * * *"

page 369:

> "Both claims were founded on defendant's failure to follow the sequence of work * * *
>
> "(1) It is clearly apparent from the evidence that defendant breached the contract * * *."

and page 370:

> "The remainder of plaintiff's claim * * * was denied * * * on the ground that it was a claim for unliquidated damages for breach of contract, notwithstanding the fact that both of plaintiff's claims * * * were founded on defendant's failure to follow the sequence * * * The letter * * * upon which defendant relies, refers to the June 27, 1949, letter and appears to be no more than an affirmation of that decision which clearly was not decided on a question of fact." (Emphasis supplied.)

Here it is not conceded that the government conducted the inspection in such a way as to unduly delay the work. To the contrary, the government insists that it conducted the inspection with all reasonable dispatch and further that the delay was caused by unforeseen circumstances. These contentions presented the factual dispute which the administrative agency should have first resolved.

It is true that the court goes on with this language:

> "No findings of fact were made by the contracting officer. Even if the August letter is con-

> sidered by itself the most that can be said for defendant is that it is ambiguous. Certainly if the contracting officer's decision is to be accorded finality it should be unequivocal and clear enough to apprise plaintiff of whether it was based on a question of fact or law so that plaintiff can reasonably determine whether an appeal is warranted. When the decision is ambiguous, as the August letter is, we must look to surrounding circumstances to determine its meaning."

This language may suggest that if a contracting officer made a decision which recited that he finds as a matter of law that a contractor's claim must be denied, the contractor would be warranted in ignoring the appeal provisions. But it should be noted that the last part of the above-quoted language indicates that if the officer's decision is ambiguous surrounding circumstances must be considered. The court went on to state:

> "In so doing (looking at the surrounding circumstances) we conclude that the contracting officer's decision was based on a question of law and, therefore, it was unnecessary (to appeal)." (Parenthetics supplied.)

A contractor cannot hold the contracting officer's letter up in the abstract. He has to consider the nature of his claim. And, as here, if the surrounding circumstances indicate that the decision is based on facts as well as law appeal would be necessary. The opinion of the contracting officer that the issue

involved was one of law rather than fact does not make it such.

A further review of the matter upon plaintiff's motion to reconsider does not convince me that I was in error in concluding that defendant's motion for summary judgment should be granted.

Dated November 16, 1959.

/s/ WILLIAM J. LINDBERG,
United States District Judge.

[Endorsed]: Filed November 16, 1959.

[Title of District Court and Cause.]

STIPULATION

Plaintiff and defendant hereby stipulate the following facts for pretrial purposes only, said stipulation not being binding upon either party at trial unless further agreed:

I.

That prior to the bid of plaintiff on the contract underlying the subject action (attached hereto as Exhibit "A"), neither plaintiff nor defendant knew of a buildup of silt, sand and other materials under ramps B and C which was later discovered by plaintiff.

II.

That prior to learning of the buildup of said materials under ramps B and C, neither plaintiff nor defendant expected or anticipated that the required

independent Engineering Service Contract for underwater inspection would take longer than three (3) or four (4) days for each ramp.

III.

That inspection of underwater conditions at ramp B commenced on July 8, 1959, as requested by plaintiff. That because of the buildup of said materials under the ramps, the Engineering Service contractor worked July 8, 9, 10, 11 and 31, and August 1, 2, 5 and 6, 1957, inclusive, to complete the inspection of ramp B. Subsequently, more extensive inspection work was required on ramp C than earlier anticipated.

IV.

That subsequent to the completion of the inspection of ramp B, the officer-in-charge of construction at Seattle, Washington took two (2) days to receive and evaluate the construction report and determine which piles should be replaced.

V.

That after determination that changes were necessary in the Engineering Service Contract, a period of thirteen (13) work days ensued from July 12, to July 30, 1957, inclusive, during which time funds were obtained and authorization secured, both from Washington, D. C., for the additional inspection work necessary.

VI.

That because of the additional time required for the underwater inspection, plaintiff was prevented

from completing his work on his contract in the manner plaintiff then desired with some claimed additional resultant expense.

VII.

That on July 23, 1957, plaintiff forwarded a letter (attached as Exhibit "B") to the Navy, which was received July 24th.

VIII.

That subsequently, inspection was completed and the plaintiff finished its work under the contract (Exhibit "A") including two (2) contract amendments which added to the time for performance and compensation of plaintiff.

IX.

That on November 12, 1957, plaintiff forwarded a claim for rentals and wages lost due to delays in substructure inspection to the Resident Officer-in-Charge of Construction, Oak Harbor, Washington (Exhibit "C").

X.

That on November 15, 1957, said resident officer-in-charge of construction wrote plaintiff a letter (Exhibit "D") referencing certain portions of the contract.

XI.

That on December 4, 1957, plaintiff filed a claim (Exhibit "E") with the Officer-in-Charge of Construction, Thirteenth Naval District, Seattle, Washington.

XII.

That on January 14, 1958, plaintiff filed a release (Exhibit "F") upon payment under the contract except for its claim of December 4, 1957.

XIII.

That on January 28, 1958, the Officer-in-Charge of Construction, Thirteenth Naval District, denied plaintiff's claim by letter (Exhibit "G").

XIV.

That on February 18, 1958, plaintiff presented his claim by letter (Exhibit "H") to the contracting officer in accordance with terms of contract.

XV.

That on March 31, 1958, the contracting officer denied plaintiff's claim by letter (Exhibit "I").

XVI.

That plaintiff has made no appeal under the contract of the contracting officer's decision.

Dated this 30th day of September, 1959.

/s/ CHARLES P. MORIARTY,
United States Attorney;

/s/ GEORGE S. LUNDIN,
Assistant United States Attorney, Counsel for Defendant.

/s/ R. STUART THOMSON,
Counsel for Plaintiff.

[Endorsed]: Filed October 8, 1959.

United States District Court, Western District of Washington, Northern Division

No. 4686

McCRAY MARINE CONSTRUCTION CO.,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

ORDER

The defendant bringing on its motion for summary judgment in open court on October 21, 1959; the court having heard arguments from counsel for both parties and the court having examined the briefs submitted concerning this court's jurisdiction to try and determine the above-entitled action when the plaintiff failed to exhaust its administrative remedies as required under the contract underlying said action; and the court finding that plaintiff's allegations that the defendant breached its contract with plaintiff involved questions of a factual nature whether plaintiff was unnecessarily or unreasonably delayed by defendant and whether damage resulted to plaintiff from any delay; and the court finding further that such factual issues must be presented and determined not only by the contracting officer, but also, if adverse to plaintiff on appeal under the disputes clause of said contract even if said contracting officer's decision was made without consideration of the facts or without a factual finding by

the contracting officer; and it appearing beyond question that the plaintiff failed and neglected to pursue its administrative remedies as required, this court does find that it has no jurisdiction to try and determine this action.

Considering said findings, this court now therefore does grant defendant's motion for summary judgment and orders the above-entitled case dismissed with prejudice.

Dated November 17, 1959.

/s/ WILLIAM J. LINDBERG,
United States District Judge.

Approved and Presented:

/s/ GEORGE S. LUNDIN,
Assistant United States Attorney, Counsel for Defendant.

Approved as to Form:

/s/ R. STUART THOMSON,
Counsel for Plaintiff.

Lodged October 23, 1959.

[Endorsed]: Filed November 17, 1959.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that McCray Marine Construction Company, the above-named plaintiff,

hereby appeals to the United States Court of Appeals for the Ninth Circuit from the order granting defendant's motion for summary judgment of dismissal entered in this action on November 17, 1959.

Dated this 18th day of November, 1959.

/s/ R. STUART THOMSON,
Attorney for Appellant.

[Endorsed]: Filed November 19, 1959.

[Title of District Court and Cause.]

BOND FOR COSTS ON APPEAL

Know All Men By These Presents:

That McCray Marine Construction and A. Walter McCray, owner, as principal, and Continental Casualty Company, an Illinois corporation, as surety, are held and firmly bound unto the defendant, United States of America, in the full and just sum of $250.00, to be paid to the defendant, United States of America, to which payment will and truely be made, we bind ourselves, our successors and assigns, jointly and severally by these presents.

Sealed with our seals and dated this 20th day of November, 1959.

Whereas on November 17, 1959, in an action pending in the United States District Court for the Western District of Washington, Northern Division, between McCray Marine Construction Company, as

plaintiff and the United States of America, as defendant, an order granting defendant's motion for summary judgment of dismissal was rendered against the said McCray Marine Construction Company and the said McCray Marine Construction Company having filed a notice of appeal from such district court to the United States Court of Appeals for the Ninth Circuit;

Now, therefore the condition of this obligation is such that if the said McCray Marine Construction Company shall prosecute its appeal to effect and shall pay costs if the appeal is dismissed or the order affirmed, or such costs as the said Court of Appeals may award against said McCray Marine Construction Company if the judgment is modified, then this obligation to be void; otherwise remain in full force and effect.

McCRAY MARINE
CONSTRUCTION,

By /s/ A. WALTER McCRAY,
Owner.

[Seal] CONTINENTAL CASUALTY
COMPANY,

By /s/ RALPH B. CHAMBERLAIN,
Its Attorney-in-Fact.

State of Washington,
County of King—ss.

On November 20, 1959, before me personally came Ralph B. Chamberlain, who being by me duly sworn

deposes and says, that he resides in the City of Seattle, State of Washington, and that he is the Attorney-in-Fact of the Continental Casualty Company, and knows the corporate seal thereof; that said Company is duly and legally incorporated under the laws of the State of Illinois; that the seal affixed to the above bond is the corporate seal of the said Continental Casualty Company, and was thereto affixed by order and authority of the Board of Directors of said Company; and that he signed his name thereto by like order and authority as Attorney-in-Fact of said Company; and that the assets of said Company, unencumbered and liable to execution, exceed its claims, debts and liabilities, of every nature whatever, by more than the sum of $50,000.

[Seal] /s/ R. STUART THOMSON,
Notary Public in and for the State of Washington,
Residing at Seattle.

Lodged November 23, 1959.

[Endorsed]: Filed December 4, 1959.

[Title of District Court and Cause.]

STATEMENT OF POINTS

Plaintiff-appellant presents the following points upon which he claims the trial court erred:

(1) In a failure to find that the final decision of the Contracting Officer, recited in a letter dated March 31, 1958, was based on a question of law.

(2) In a failure to rule that an administrative appeal is not required, under Section 57 of the contract in question, from the decision of the Contracting Officer, which is based on a question of law, and even if required, the 30 day appeal period prescribed for disputes of fact would not be applicable but an appeal could be taken within a reasonable time.

(3) In ruling that potential factual issues, undisputed prior to or at the Contracting Officer's level, must nevertheless be appealed within 30 days to the Secretary of the Navy in accordance with Section 57 of the contract pertaining to disputes of fact or the claim will fail for failure to exhaust ones administrative remedies.

(4) In assuming that the Contracting Officer's final decision of March 31, 1958, was ambiguous without so finding or in what respect.

(5) After apparently concluding the Contracting Officer's letter of March 31, 1958, was ambiguous, in failing to consider only those circumstances existing on March 31, 1958, the time when the decision was made, and, on the other hand, in considering contentions first made at a much later date in the answer, specifically, paragraph IV, line 7, page 2 where the defendant answered:

> "Defendant further avers that inspection of the substructure of ramps 'B' and 'C' was accomplished with all due diligence after plaintiff advised work was not being performed according to schedule by plaintiff. Defendant asserts

that certain delays are inherent in underwater inspection and should have been foreseen by plaintiff."

in determining whether the Contracting Officer's decision was based on a question of law or fact or both.

(6) In failing to find that the surrounding circumstances existing on March 31, 1958, revealed the Contracting Officer based his decision, in denying the plaintiff's claim, on a question of law.

(7) In a failure to find that the United States District Court had jurisdiction over a claim for unliquidated damages against the United States of America regardless of whether the claim was presented for administrative consideration or whether any appeal was taken from an adverse administrative decision on a matter which it could not legally consider.

(8) In signing the order granting defendant's motion for summary judgment because the plaintiff had not exhausted the administrative remedies available and dismissing plaintiff's complaint with prejudice.

/s/ R. STUART THOMSON,
Attorney for Appellant.

Receipt of copy acknowledged.

[Endorsed]: Filed December 14, 1959.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK U. S. DISTRICT COURT TO RECORD ON APPEAL

United States of America,
Western District of Washington—ss.

I, Harold W. Anderson, Clerk of the United States District Court for the Western District of Washington, do hereby certify that pursuant to the provisions of Subdivision 1 of Rule 10 of the United States Court of Appeals for the Ninth Circuit, and Rule 75(o) FRCP, and designation of counsel, I am transmitting herewith the following original documents in the file dealing with the action, as the record on appeal herein to the United States Court of Appeals for the Ninth Circuit at San Francisco, said papers being identified as follows:

1. Complaint, filed Sept. 26, 1958.

4. Answer of defendant, filed Jan. 15, 1959.

22. Motion defendant for Summary judgment, filed Dec. 14, 1959.

24. Stipulation of facts with exhibits A, B, C, D, E, F, G, H, and I attached, filed Oct. 8, 1959.

30. Court Reporter's Transcript of Court's Oral Decision, filed 10-22-59.

31. Motion for Reconsideration and for Order Denying Defendant's Motion for Summary Judgment Notwithstanding Court's Oral Decision, filed 10-27-59.

32. Memorandum Opinion Denying Plaintiff's Motion for Reconsideration, filed Nov. 16, 1959.

33. Order granting Defendant's Motion for Summary Judgment and Dismissal of case with prejudice, filed Nov. 17, 1959.

34. Notice of Appeal, filed Nov. 19, 1959.

35. Bond for Costs on Appeal, filed Dec. 4, 1959.

36. Designation of Contents of Record on Appeal, filed Dec. 14, 1959.

37. Statement of Points, filed Dec. 14, 1959.

I further certify that the following is a true and correct statement of all expenses, costs, fees and charges incurred in my office by appellant for preparation of the record on appeal in this cause, to wit: Filing fee, Notice of Appeal, $5.00; and that said amount has been paid to me by the attorneys for the appellant.

In Witness Whereof I have hereunto set my hand and affixed the official seal of said District Court at Seattle this 18th day of December, 1959.

[Seal] HAROLD W. ANDERSON,
Clerk;

By /s/ TRUMAN EGGER,
Chief Deputy.

[Endorsed]: No. 16728. United States Court of Appeals for the Ninth Circuit. McCray Marine Construction Company, Appellant vs. United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the Western District of Washington, Northern Division.

Filed December 21, 1959.

Docketed: December 31, 1959.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

No. 16732

In the United States Court of Appeals for the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

INTERNATIONAL HOD CARRIERS', BUILDING AND COMMON LABORERS' UNION OF AMERICA, LOCAL 300, AFL-CIO, RESPONDENT

ON PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD

STUART ROTHMAN,
General Counsel,
DOMINICK L. MANOLI,
Associate General Counsel,
MARCEL MALLET-PREVOST,
Assistant General Counsel,
ROSANNA A. BLAKE,
ROBERT SEWELL,
Attorneys,
National Labor Relations Board.

INDEX

AUTHORITIES CITED

Cases:

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In the United States Court of Appeals for the Ninth Circuit

No. 16732

NATIONAL LABOR RELATIONS BOARD, PETITIONER

v.

INTERNATIONAL HOD CARRIERS', BUILDING AND COMMON LABORERS' UNION OF AMERICA, LOCAL 300, AFL–CIO, RESPONDENT

ON PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

JURISDICTION

This case is before the Court upon the petition of the National Labor Relations Board pursuant to Section 10(e) of the National Labor Relations Act, as amended (61 Stat. 136, 65 Stat. 601, 73 Stat. 519, 29 U.S.C. Sec. 151 *et seq.*),[1] for enforcement of its order against the International Hod Carriers' Building and Common Laborers' Union of America, Local 300, AFL–CIO (herein called the Union), on May 20, 1959, following the usual proceedings under Section 10 of the Act. The Board's decision and order (R. 27–30)[2] are reported at 123 NLRB 1231. This Court

[1] The relevant statutory provisions are reprinted, *infra*, pp. 16–19.

[2] Reference to the printed record are designated "R." In a series of references, those preceding the semicolon are to the Board's findings; those following are to the supporting evidence.

has jurisdiction of the proceedings, the unfair labor practices having occurred in the area of Los Angeles, California, within this judicial circuit.

STATEMENT OF THE CASE

I. The Board's findings of fact

Briefly stated, the Board found that respondent violated Section 8(b) (2) and (1)(A) of the Act by causing Martin Brothers, an employer, to discharge employees Monico C. Garcia and Jesse Gallego for their failure to adhere to respondent's internal rules governing job referral. The Board also found that Martin Brothers' operations affect commerce within the meaning of the Act and that it would effectuate the purposes of the Act to assert jurisdiction in this case. The facts upon which these findings rest are summarized below.

A. The Operations of the Employer

The employer, Martin Brothers, is a partnership engaged in lathing and plastering contracting in the Los Angeles area, and employs both laborers and plaster tenders (i.e., hod carriers). The firm belongs to the Contracting Plasterers' Association of Southern California, Inc., which negotiates and signs association-wide collective bargaining agreements on behalf of its 326 members (R. 13, 42, 44). The Union has such a contract with the Association covering plaster tenders but has no contract with it covering laborers (R. 17–18; 42, 55).[3]

[3] The Union has a contract with a number of other employer associations governing laborers (R. 62–63).

B. The Unfair Labor Practices

Martin Brothers has no fixed hiring policy with respect to laborers (R. 20; 54). It hires "at the gate," or upon the recommendation of other employees, and, on occasion, calls the Union hiring hall (*ibid.*).

Monico C. Garcia and Jesse Gallego on their own initiative went to Martin Brothers' Wilshire Terrace project on Friday, April 18, 1958, and were hired and worked that day as laborers (R. 15; 45, 59–60). Both were, and continued to be, members of the Union in good standing (R. 15; 45–47, 49). They reported for work on the next workday, Monday, April 21, but were not permitted to start (R. 15; 45–46, 60). Respondent's Assistant Business Agent, Dan Gomez, was on the scene and found out that Garcia and Gallego had obtained the jobs directly and did not have Union clearance (R. 15; 46–51, 52, 60). In the presence of the two men, Gomez told Foreman Arthur Sherman" * * * these men have to get off the job because they have no clearance for the job" (R. 15; 60). Sherman immediately instructed Garcia and Gallego to "* * * go down to the local and get a clearance and come back and they had a job from there on" (*ibid.*). As directed, Garcia and Gallego went to the Union hall and told Acting Field Manager D'Amico that they had jobs and needed clearance to go back to work (R. 15–16; 47–48). Clearance was denied them, however. It was explained that they would have to register and await their turn and that the Union had "already" sent two other men to Martin Brothers (R. 16; 48). Seven weeks after

the discharge, Garcia obtained employment at the Wilshire Terrace job, apparently pursuant to the Union's referral system (R. 16; 50). During this 7-week period he made two attempts on his own to get his job back but was turned down each time for lack of Union clearance (R. 16; 50).

II. The Board's conclusions and order

Upon the foregoing facts the Board concluded that respondent caused the discharge of Garcia and Gallego for non-compliance with union rules relating to job referral, that this discrimination encouraged Union membership, and that respondent had, therefore, violated Section 8(b) (2) and (1)(A) of the Act (R. 20–21, 28). The Board also found that it had jurisdiction over respondent and that it would effectuate the purposes of the Act to assert jurisdiction in this case (R. 14, 21).

The Board's order requires respondent to cease and desist from engaging in the unfair labor practice found, and from in any other manner restraining or coercing employees in the exercise of the rights guaranteed them by the Act. Affirmatively, the order directs respondent to make Garcia and Gallego whole for any loss of pay resulting from the discrimination, to notify Martin Brothers and the two men, in writing, that it withdraws its objection to their employment, and to post appropriate notices (R. 28–30).

ARGUMENT

I. Substantial evidence on the record as a whole supports the Board's finding that respondent violated Section 8(b) (2) and (1)(A) of the Act by causing Martin Brothers to discharge employees Garcia and Gallego

The facts set forth, *supra,* pp. 2–4, establish that Garcia and Gallego would have continued to work for Martin Brothers if Union Representative Gomez had not told Company Foreman Sherman that the two men had "to get off the job" because they did not have "clearance" from the Union, and if the Union had not then refused to give them clearance.[4] While it is true that an employer and a union may, under appropriate circumstances, enter into a lawful hiring agreement, the record amply supports the Board's finding that the Union had *no* contract with Martin Brothers. And respondent's answer to the Board's

[4] Respondent apparently referred members, at least, in rotation, *supra*, p. 3. However, Union Field Manager D'Amico testified on direct examination as follows with respect to a conversation with one of the Martins at a different project (Tr. 126, 146):

"A. About two weeks before this case. I told him, I says, 'Here we go again.' I says, 'Now you have got this laborer here, we just took one off another job. Now you have got this man.' * * * Well, I said, 'Here is a man, they don't belong to the union, working with the latherers. Now you are violating your agreement again.'

On cross-examination D'Amico testified as follows with respect to the same incident (Tr. 146):

Q. This Tidewater situation, that involved the plaster tenders didn't it?

A. No, the laborers. I had gone over there for a jurisdiction dispute, for, with the plasterers, and while I was walking down, I noticed the lathers was working, and I seen this laborer and I asked him to show me his book."

petition for enforcement appears to concede that the Board's finding that its action violated Section 8(b)(2) and (1)(A) of the Act is proper unless the Union had a valid hiring agreement with Martin Brothers (R. 38). Cf. *N.L.R.B.* v. *International Association of Machinists, etc., Local Lodge 758, AFL–CIO,* (C.A. 9), 46 LRRM 2465, 2468 (June 4, 1960); *Morrison-Knudson, Inc.* v. *N.L.R.B.,* 270 F. 2d 864, 865 (C.A. 9). See also, *Radio Officers' Union* v. *N.L.R.B.,* 347 U.S. 17, 42; *N.L.R.B.* v. *Local 542, Operating Engineers,* 255 F. 2d 703, 704–705 (C.A. 3); *N.L.R.B.* v. *Brotherhood of Painters, Local 419,* 242 F. 2d 477, 481 (C.A. 10).

Respondent's contention is that it had a valid contract with Martin Brothers which required the latter to hire exclusively through the Union, that the Company violated that contract when it hired the two men directly, and that the Union's demand that they be discharged was therefore lawful. However, as we demonstrate below, the Board properly concluded that the Union had *no* hiring agreement with Martin Brothers at the time of the events here in issue.

Concededly, in 1946, W. L. Martin (a partner in Martin Brothers) signed "Articles of Agreement" with the Building and Construction Trades Councils of which the Union is a member (R. 66–68). At that time W. L. Martin was doing business as an individual and was engaged in general contracting, which required him to hire laborers as well as other craftsmen. On the other hand, Martin Brothers is a partnership and is engaged exclusively in lathing and plastering (R. 53, 57). The Articles, consisting of six

paragraphs, apply to "all work" which comes within the jurisdiction of the Trades Council (R. 66). The second paragraph provides in pertinent part that (R. 66):

> The Contractor does hereby agree * * * that he will employ * * * upon all work * * * in the jurisdiction of said Councils and their affiliated Unions, only members in good standing in the organization to which said work properly belongs in accordance with the wage scales, classifications and working rules of the Union having jurisdiction.

The final paragraph provides for automatic renewal every year unless one of the parties gives written notice of its intent to terminate or amend the agreement (R. 68). Admittedly, W. L. Martin, who signed the Articles in 1946, has never given the Trades Councils notice of his intent to terminate them (R. 68).

This "short form" agreement, respondent contends, "incorporates" the master agreement entered into between the Associated General Contractor (herein called AGC), and the Trades Councils and therefore binds Martin Brothers to abide by the terms of the AGC agreement in effect at any given time, including the requirement that the employer hire only through the Union. The Articles, however, contain no reference to any other agreement. In fact, the only references to matters not set forth therein are not to an AGC agreement but (1) to "wage scales, classifications, and working rules *of the Union* having jurisdiction" (R. 66, emphasis supplied), and (2) to the Company's duty to com-

ply with the "requirements *of the Council and its affiliated Unions*" for clearing workmen (R. 66–67, emphasis supplied).

Furthermore, neither W. L. Martin nor Martin Brothers has ever been a member of AGC (R. 56). W. L. Martin testified that he was "obligated to sign" the Articles in 1946 because he was not a member of AGC and he "signed [it] for that particular term of the contract, not for any subsequent contract in later years" (R. 56). His explanation was that he needed such an agreement at that time because he was doing some general contracting work for the Government (R. 57). Accordingly, in his view Martin Brothers did not have a contract with the Union with respect to laborers at the time of the events here in issue (R. 55).

But, respondent points out, Martin Brothers pays its laborers union wages and has made contributions to their health and welfare fund provided for in the AGC-Trades Council contracts since 1955 (R. 56). These facts, it argued before the Board, prove that the Company "felt obligated" to follow the AGC contract. This argument ignores the possibility that the Company could well consider it good labor relations to pay union rates and grant other benefits to its laborers, who work alongside its plaster tenders who are covered by a union contract. The Union, on the other hand, would very likely be willing to accept voluntary payments to a fund from which so many of its members would benefit. Furthermore, the record indicates that the Union itself did not consider that the 1946 Articles automati-

cally bound Martin Brothers to make payments to the fund set up in the 1955 AGC contract. Thus, respondent's witness D'Amico, testified that the date "4.5.55" appearing on the Union's records with respect to contributions to the laborers' health and welfare fund, refers to "when [Martin] signed the agreement to pay" into the fund and that the Union would not have sent the Company the "forms" if the latter had not called. Although the Union was unable to find the agreement signed by Martin in 1955, in D'Amico's words, Martin "must have had an agreement in 1955 * * * the dates are there and we we can't lie about dates." [5]

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[5] D'Amico testified (Tr. 105–110):

By Mr. SCHULLMAN:

Q. Now, I show you a similar paper or document marked for identification R–10, on top it says contractors' status, 10–23–58, and ask you if you are familiar with that?

A. Yes.

Q. And on that page, approximately 20 lines from the bottom, where somebody has marked with ink, does the name Martin Brothers appear?

A. Yes.

Q. Can you tell us what this document represents?

A. That represents the laborers. He has been paying health and welfare on the laborers on this one, and he signed it.

Q. Then it has 4–5–55, with the word "Eff" on top?

A. That is right.

Q. "Eff" is what?

A. Means effective, when he signed the agreement to pay the health and welfare.

VOIR DIRE EXAMINATION

By Mr. GRODSKY:

Q. Do you have here whatever document Martin Brothers signed in May of 1955 that is referred to in Exhibit R–10?

But even if it is assumed that respondent either believed that the 1946 Articles bound Martin Brothers to abide by the AGC-Trades Council contract in effect in 1958, or that respondent chose to so interpret the Articles, neither assumption has substantial probative value in determining the issue here, *i.e.*, whether the Articles signed by W. L. Martin in 1946 provide the Union with a defense to its otherwise illegal action in 1958.

In sum, we submit that the Board properly found that respondent had no contract in 1958 with Martin

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A. When Martin Brothers called us to send, you know, to pay his health and welfare, we called him on it verbally. We took the old agreement that he had with the building trades, and put him, took that as an agreement he had with the short form, and we sent him the papers there.

FURTHER DIRECT EXAMINATION

By Mr. SCHULLMAN:

Q. Let me ask you that, in other words, Mr. D'Amico, you did speak to him in 1955?

A. That is right. We could never send him the forms, if he didn't call us.

Q. He called you for the forms; when you use the word forms, you mean the current master agreement?

A. That is right.

Mr. GRODSKY. Who has that agreement, if there is one that has been signed?

The WITNESS. Well, at that time we had another office. Our administrator was a fellow named Cornell, and we have changed administrators since, and we are under this other fellow, fellow named Chaque, Mr. Chaque, and he is our administrator now.

The records they had out of this fellow named Mr. Cornell seems that we haven't been able to find them. We have been looking for this agreement. He must have an agreement in 1955. We wouldn't have had it in, see, the dates are there and we can't lie about the dates.

Brothers which required the latter to hire laborers exclusively through the Union, and properly concluded that, therefore, it violated Section 8(b) (2) and (1)(A) of the Act by causing Martin Brothers to discharge Garcia and Gallego because they had not complied with the Union's unilateral hiring rules.[6]

II. The Board properly asserted jurisdiction over respondent

As set forth, *supra,* p. 2, Martin Brothers employs both plaster tenders and laborers. It is one of 326 members of the contracting Plasters Association of Southern California, Inc., which bargains for and signs association-wide collective bargaining contracts covering plaster tenders on behalf of all of its members, including Martin Brothers, with numerous unions, including respondent. In the year ending July 30, 1958, one of the other Association members (A. E. Eiden and Sons of Los Angeles), performed work in Colorado valued at more than $600,000 (R. 13–14; 43–44). Respondent conceded before the Board that because of the Company's membership in the Association, the Board would have jurisdiction in a case involving the plaster tenders employed by Martin Brothers. It argued, however, that the Board did not have jurisdiction in this case because the men involved were laborers and the Association did not bargain with the Union with respect to laborers. This contention is without merit.

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[6] Should the Court disagree with the Board's finding that the Union had no contract with Martin Brothers covering the latter's laborers, we respectfully submit that the case should be remanded to the Board for it to determine whether, as respondent contends, the contract contained a valid hiring clause.

In the first place, the question of whether the Board has jurisdiction under the Act does not turn upon whether the parties have chosen to bargain with respect to the employees involved. In the second place the contention ignores the fact that Martin Brothers' laborers work side by side with its plaster tenders under the same foreman and both belong to the respondent Local (R. 58–59). Under these circumstances, it is apparent that a dispute involving laborers would immediately and directly affect the work of the plaster tenders. We submit that it would be both illogical and contrary to the purposes of the Act to conclude that the Board has jurisdiction over an employer with respect to part of his employees, but not as to others, particularly in a case in which they all work together in an integrated operation.

In *Virginia Electric and Power Company* v. *N.L.R.B.*, 115 F. 2d 414 (C.A. 4), the Company conceded that the Board had jurisdiction over its electrical business but argued that its gas and transportation businesses were "local" and beyond the Board's jurisdiction. As the court said, "A sufficient answer to this position is the unitary character of the Company's business * * * notwithstanding the division into * * * departments * * *. It is clear that wage controversies or unfair labor practices in any department of such a business will have repercussions in other departments * * *" (*Id.* at pp. 415–416). Although the Company did not raise the jurisdiction issue before the Supreme Court, the latter noted that it had been "correctly decided" by the court below.

314 U.S. 469, 476. *A fortiori* the Board properly asserted jurisdiction in this case in which the two classifications of employees work together in an integrated operation.

In short, as the Board pointed out in *Harlan B. Browning,* 120 NLRB 841, 841–842, enforced 268 F. 2d 938 (C.A. 10), it would be anomalous if some of a single employer's ordinary employees are protected by the Act while others are not. It should be remembered that in enacting the National Labor Relations Act "* * * Congress explicitly regulated not merely transactions or goods in interstate commerce, but activities which in isolation might be deemed to be merely local but in the interlacings of business across state lines adversely affect such commerce * * * [and] left it to the Board to ascertain whether proscribed practices would in particular situations adversely affect commerce when judged by the full reach of the constitutional power of Congress." *Polish National Alliance* v. *N.L.R.B.,* 322 U.S. 643, 648. The realities of the economic situation presented here indicate that the Association's substantial interstate dealings could well be affected adversely by labor disputes with the laborers and that the impact on commerce cannot be compartmentalized on the basis of whether the employees involved are covered by a contract. We submit, therefore, that the Board has jurisdiction in this case.

Furthermore, as the Board has said, the "clear effect of * * * [Association-wide] bargaining is the establishment of a relationship whose impact on commerce reaches beyond the confines of any one em-

ployer involved in the joint bargaining and is coextensive with the totality of the operations of all the employers so involved." *Vaughn Bowen,* 93 NLRB 1147, 1150, quoted with approval by the Court in affirming the Board's assertion of jurisdiction in a similar situation. *N.L.R.B.* v. *Gottfried Baking Co.,* 210 F. 2d 772, 778 (C.A. 2). As the Second Circuit also noted, this Court has also upheld the Board's assertion of jurisdiction on the same basis. See *Leonard* v. *N.L.R.B.,* 197 F. 2d 435, 436, n. 1, in which there was no evidence that any individual company engaged in commerce in sufficient volume to give the Board jurisdiction over it standing alone. Cf. *Joliet Contractors Association* v. *N.L.R.B.,* 193 F. 2d 833, 839–840 (C.A. 7), in which the Court reversed the Board's dismissal of a complaint on jurisdictional grounds and ruled that the Board should have considered the "totality of the situation" rather than merely viewing the activities of each individual company in isolation.

Respondent also appeared to contend before the Board that even if the Board has jurisdiction, its decision to exercise it in this case was improper. This Court has pointed out, however, that this question is for the Board, not the Courts, to determine and is not justiciable, absent evidence, which is lacking here, that the Board's action constitutes "unjust discrimination." *N.L.R.B.* v. *Jones Lumber Company, Inc.,* 245 F. 2d 388, 390–391, n. 7.

CONCLUSION

For the foregoing reasons we respectfully submit that a decree should issue enforcing the Board's order in full.

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JULY 1960.

APPENDIX

The relevant provisions of the National Labor Relations Act, as amended (61 Stat. 136, 65 Stat. 601, 72 Stat. 945, 73 Stat. 519, 29 U.S.C., Secs. 151 *et seq.*), are as follows:

RIGHTS OF EMPLOYEES

SEC. 7. Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a)(3).

UNFAIR LABOR PRACTICES

SEC. 8. (a) It shall be an unfair labor practice for an employer—

(1) to interfere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 7;

* * * * *

(3) by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization * * *

* * * * *

(b) It shall be an unfair labor practice for a labor organization or its agents—

(1) to restrain or coerce (A) employees in the exercise of the rights guaranteed in section 7: *Provided,* that this paragraph shall not impair the right of a labor organization to prescribe its own rules with respect to the acquisition or retention of membership therein; * * *

(2) to cause or attempt to cause an employer to discriminate against an employee in violation of subsection (a)(3) or to discriminate against an employee with respect to whom membership in such organization has been denied or terminated on some ground other than his failure to tender the periodic dues and the initiation fees uniformly required as a condition of acquiring or retaining membership;

* * * * *

PREVENTION OF UNFAIR LABOR PRACTICES

SEC. 10. (a) The Board is empowered, as hereinafter provided, to prevent any person from engaging in any unfair labor practice (listed in section 8) affecting commerce. This power shall not be affected by any other means of adjustment or prevention that has been or may be established by agreement, law, or otherwise: * * *

(c) * * * If upon the preponderance of the testimony taken the Board shall be of the opinion that any person named in the complaint has engaged in or is engaging in any such unfair labor practice, then the Board shall state its findings of fact and shall issue and cause to be served on such person an order requiring such person to cease and desist from such unfair labor practice, and to take such affirmative action including reinstatement of employees with or without back pay, as will effectuate the policies of this Act: * * *

(e) The Board shall have power to petition any court of appeals of the United States, or if all the courts of appeals to which application may be made are in vacation, any district court

of the United States, within any circuit or district, respectively, wherein the unfair labor practice in question occurred or wherein such person resides or transacts business, for the enforcement of such order and for appropriate temporary relief or restraining order, and shall file in the court the record in the proceedings, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition, the court shall cause notice thereof to be served upon such person, and thereupon shall have jurisdiction of the proceeding and of the question determined therein, and shall have power to grant such temporary relief or restraining order as it deems just and proper, and to make and enter a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board. No objection that has not been urged before the Board, its member, agent, or agency, shall be considered by the court, unless the failure or neglect to urge such objection shall be excused because of extraordinary circumstances. The findings of the Board with respect to questions of fact if supported by substantial evidence on the record considered as a whole shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for the failure to adduce such evidence in the hearing before the Board, its member, agent, or agency, the court may order such additional evidence to be taken before the Board, its member, agent, or agency, and to be made a part of the record. The Board may modify its findings as to the facts, or make new findings, by reason of additional evidence so taken and filed, and it shall file such modified or new findings, which findings with respect to questions of fact if supported by substantial evidence on the record

considered as a whole shall be conclusive, and shall file its recommendations, if any, for the modification or setting aside of its original order. Upon the filing of the record with it, the jurisdiction of the court shall be exclusive and its judgment and decree shall be final, except that the same shall be subject to review by the appropriate United States court of appeals if application was made to the district court as hereinabove provided, and by the Supreme Court of the United States upon writ of certiorari or certification as provided in section 1254 of title 28.

DEFINITIONS

SEC. 2. When used in this Act—

* * * * *

(7) The term "affecting commerce" means in commerce, or burdening or obstructing commerce or the free flow of commerce, or having led or tending to lead to a labor dispute burdening or obstructing commerce or the free flow of commerce.

U.S. GOVERNMENT PRINTING OFFICE: 1960

No. 16732

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

NATIONAL LABOR RELATIONS BOARD,

Petitioner,

vs.

INTERNATIONAL HOD CARRIERS', BUILDING AND COMMON LABORERS' UNION OF AMERICA, LOCAL 300, AFL-CIO,

Respondent.

On Petition for Enforcement of an Order of the National Labor Relations Board, and on Answer by Petitioner for Review and Setting Aside of the Order of the National Labor Relations Board.

Brief for Respondent, International Hod Carriers', Building and Common Laborers' Union of America, Local 300, AFL-CIO.

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BRIEF OF RESPONDENT.

I.

Jurisdiction.

We concur that the jurisdiction of this Court is as set forth in the Brief for the Petitioner.

We add thereto, however, that it is additionally invoked by the Answer of the Respondent [R. 36] requesting review and setting aside of the Order of the National Labor Relations Board.

II.
Statement of the Case.

While Petitioner is correct in its statement of the case that the Board did make the Findings indicated, under the testimony adduced at the hearing before the Trial Examiner, Respondent maintains that there was no violation of Section 8(b) (2) and (1)(A) of the Act, and that Respondent Union was operating under a valid short form Agreement [Pet. Ex. 1; R. 66].

At this juncture, may we note that while the Board filed its Certificate with this Court certifying all documents in this case, including the stenographic transcript of the testimony taken before the Trial Examiner on December 3, 4 and 18, 1958, together with all Exhibits and Items 5 and 6 of said Certificate of February 8, 1960 of the National Labor Relations Board, which items are the Respondent's Motion for Reconsideration, received under date of August 11, 1959, and a copy of the Order denying the Motion, issued by the National Labor Relations Board, of September 4, 1959; and while the Respondent, in the Answer to the Petition for Enforcement, filed with this Court [R. 36], stated in Paragraph 3 thereof:—

> "Respondent assumes that the Board will proceed and file the transcript as set forth in said Paragraph 3 of said Petition."

and said Answer continues to refer to the "record as a whole," and said Answer [R. 38], in its Wherefore clause, states:—

> "Wherefore, Respondent herein respectfully prays that this Honorable Court review this entire case and upon such review and upon the entire transcript . . ."

Nonetheless, the actual transcript of the record contains portions of the testimony, and also omits the Motion of Respondent for Reconsideration addressed to the Board, and the Order of the Board thereon, and certain exhibits admitted in evidence and offered by Respondent.

Reference will be made by Respondent to portions of the stenographic transcript of the testimony taken before the Trial Examiner, and to Respondent's Motion for Reconsideration, to the Order of the National Labor Relations Board denying said Motion, and the omitted exhibits of Respondent, all contained in the entire record filed with this Court.

Martin Bros. did have a contract with Respondent Union which covered the plaster tenders, one of the classifications, by reason of being a member of an association, which association signed a master contract [R. 13, 42, 44]. Martin Bros. had a short form agreement with Respondent Union, which tied in with the master Building Trades agreement, covering laborers [stenographic transcript of testimony before the Trial Examiner; testimony of witness, Joseph D'Amico; Trial Examiner Tr. 73-81 incl.; Resp. Ex. 1; R. 66].

The factual statement on the part of Respondent concerning the unfair labor practices again differs from that of Petitioner.

Since their original short form agreement signed between the parties [Resp. Ex. 1; R. 66], there has been a collective bargaining relationship, both with respect to laborers and with respect to plaster tenders, between the Martin Bros. and the Union. This is unequivocally set forth in the transcript of the testimony before the Trial Examiner, in the testimony of Respondent's witness, Joseph D'Amico [transcript of testimony before the Trial Examiner, 67, 104, 109, *et seq.*].

This is especially clear in said testimony [transcript of stenographic testimony before the Trial Examiner, 105-115 incl.; Resp. Exs. 9, 10, 11].

Accordingly, the Respondent's statement of the case is simple; there was no commission of any unfair labor practices under any section of the Act; the individual employees, in violation of the collective bargaining agreement, were hired without a referral from the Union; other employees, members and nonmembers alike, whose names appeared on the list for chronological referral, were discriminated against; and the only factual situation is that a violation occurred by the employer of the contract.

The Board's Conclusions and Order as covered in the Brief of Petitioner are without reference to the substantial facts in the case, which overwhelmingly require reversal of the Board's Decision and Order.

III.

Argument.

A. Respondent Had a Valid Short Form Agreement With Martin Bros.

The entire issue in this case was limited to the question of whether there was a short form agreement in existence. If it existed, there were no unfair labor practice violations.

Respondent's Exhibit 1 [R. 66], the testimony of Joseph D'Amico in behalf of Respondent [transcript of stenographic testimony before the Trial Examiner 67, 104, 109, 115 *et seq.*] and Respondent's Exhibits 2, 3, 4, 5, 6, 7, 8, 9, 10 and 11, clearly establish the existence of the short form agreement and its operation between the parties.

Originally and at all times, it was the contention of the Board, that there was no existing contract. The law is hornbook that short form agreements automatically renewable from year to year, with definite cancellation dates, are valid.

The Decision and the Order of the Board, dated May 20, 1959, did not decide with respect to the existence, or nonexistence, of any agreement; in fact, the Decision merely adopted the Intermediate Report and the Recommended Order of the Examiner of January 27, 1959.

In *Bay Area Painters And Decorators Joint Committee, Inc. v. Orack,* 102 Cal. App. 2d 81, at pages 82, 83, the Court said:—

> "An employer who is not a member of one of the associations may become a party to the agree-

ment either by joining the association or by signing the agreement individually; in the latter case such a party is designated a nonmember signatory."

That was exactly the status of Martin Bros. in their short form contract [R. 66] with the Respondent Union.

Short form agreements in the building and construction industry are not new.

Where employers are members of an association, they become parties to the master agreement through the association; where they are not members of the association, they sign or adopt short forms agreeing to be bound by the provisions of the master contract.

The case of *Levinsohn Corp. v. Joint Board of Cloak, Suit, Skirt, etc.,* 299 N. Y. 454 held valid the same type of short form agreement that was involved in the instant case.

The facts establish a valid short form agreement [testimony of Joseph D'Amico; transcript of stenographic testimony of Trial Examiner, 67, 104, 109, 115 *et seq.; Respondent's Exs.* 2, 3, 4, 5, 6, 7, 8, 9].

Moreover, it was established without any contradiction [transcript of stenographic testimony of Trial Examiner 113, 114] that Martin Bros. paid health and welfare, both on the plasterers, and then on the laborers since 1955.

We quote from such testimony, as follows:—

[Pp. 113, 114 and 115]:

"Q. (By Mr. Schullman): Now I show you—Mark that R-11 for identification.

(Thereupon, the document above referred to was marked Respondent's Exhibit No. 11 for identification.)

Q. (By Mr. Schullman): I show you a document marked R-11 for identification, and ask you if you are familiar with that document? A. Yes.

Q. At whose request was that prepared?

A. Mine, by me.

Q. What records were used in the preparation?

A. We called the trust office; they have a record for every man that has been paid by the contractor.

Q. Who dictated this? A. Our trust office gave us this copy.

Q. As I believe this page shows, is it correct that Martin Brothers Plastering is reported paid in health and welfare, plasters code No. since 1953? A. That is for the plasters on top.

Q. And then it shows next that Martin Brothers has reported and paid health and welfare on a number of laborers code number 86219 since June 1955? A. That is correct.

Q. That is approximately the same time when the health and welfare began? A. That is right.

Mr. Schullman: I now ask to be offered in evidence R-11.

The Witness: These are what they paid in each month, soforth.

Q. (By Mr. Schullman): before we offer it, going back to—do you have a legend here, 1955, and the dates and the number? A. That is right.

Q. I presume the dates, the months reflect the months of 1955? A. That is right.

Q. The numbers reflect the number of employees that they used at that time? A. That is right.

Q. And whom they paid? A. That shows how many men that they used that particular month.

Q. Would that be laborers or plaster tenders? A. That would be laborers.

Q. Laborers? A. That is right.

Q. Would that be true of 1956? A. Yes.

Q. With respect to 1957, the numbers opposite the months, does that indicate the number of employees used by Martin Brothers during that month? A. That is right.

Q. And those were what, plaster tenders or laborers? A. Laborers.

Q. Referring to the other, to 1956, and in the right-hand side, which has January through December '56, and then it has numbers, does that show the number of laborers employed on whom payment was made during that period? A. That is laborers.

Q. Is that also true of 1958? A. That is right."

It is clear now, even though the Trial Examiner took a dual and incongrous position, that the Board determined that only a single issue is involved in this case.

This is clear from the Brief for the Petitioner, and this is clear as a result of the Motion of Respondent

for Reconsideration filed with the Board, and which Motion was denied by the Order of the Board on September 4, 1959 (see Order of the Board) wherein the Board clearly found only that "no contractual arrangement presently exists between the Respondent and Martin Brothers—."

The Board further stated:—

> "The Board did not undertake to decide whether the hiring clause in the present contract with the Associated General Contractors conforms with the requirements of the *Mountain-Pacific* case."

Hence, since the record is unmistakably clear that there is a short form agreement [Resp. Ex. 1; R. 66] that Martin Brothers and the Union proceeded thereunder; that Martin Brothers paid health and welfare continuously under said agreement [Resp. Ex. 11], the Court's Findings on this issue must be reversed.

In *Lewis v. Cable Co.* D. C. W. Pa. (1952), 30 L. R. R. M. 2603, it was held that the Coal Company was estopped from denying authority of the Coal Operators' Association to enter into National Bituminous Coal Wage Agreements where the facts showed that the Company made payments into the United Mine Workers Welfare and Retirement Fund under 1948 agreement, and that the Union believed that it had a contract with the Company.

In this case, there was no question but, in fact, it was admitted, that Martin Brothers did pay into the health and welfare fund of the laborers from 1955 to at least 1958. There is no question that the short form agreement [Resp. Ex. 1; R. 66], was real, valid and subsisting.

In *Distillery Rectifying & WWIU v. Brown,* 308 Ky. 380, it was held that where there is a contract providing for automatic renewal, *it is necessary* for either party to notify the other of their intent not to renew; otherwise, the contract will be renewed automatically.

See also:

Aluminum Co. of America v. NLRB (7th Cir.), 159 F. 2d 523.

The California law is clear that a collective bargaining agreement with an automatic renewal date is automatically extended on failure to give the specifically required notice of termination.

Montaldo v. Hires Bottling Co., 59 Cal. App. 2d 642.

B. The Board Did Not Properly Assert Jurisdiction Over the Respondent.

However, we shall not advance argument on this phase since the entire case should be dismissed, predicated on the fact there was a valid short form agreement; that Martin Brothers, the employer, violated the agreement and did not utilize the referral of the union, thereby discriminating against a long list of union and nonunion employees who were on the list.

We believe it is conceded throughout the Brief filed for Petitioner, and, in fact, in the entire case, that if there is a short form agreement in existence, and it confounds the intelligence to deny the existence of such an agreement, in view of Respondent's Exhibit 1 [R. 66], and in view of the admitted testimony of payments by Martin Brothers on labor, health and welfare pro-

grams, then the Union was entitled to take the action to enforce its contract and there was no violation of Section 8(b)(2) and (1)(A) of the Act.

This Court in the remand in the case of *National Labor Relations Board v. Mountain-Pacific Chapter of Assoc. Gen. Con.,* 270 F. 2d 425, 429, specifically objected to the finding of the Board that the contract of the employer and union was illegal *on its face* because it did not contain the safeguards the Board wrote for legal hiring agreements in the *Mountain-Pacific* case.

The 9th Circuit Court in the *Mountain-Pacific* case laid down a simple premise that an exclusive hiring hall in itself is not illegal, and a contract providing one is not invalid merely because the parties did not write in language to prohibit discriminatory hiring. The Court stated:—

> "It is apparent then that a contract which contains discriminatory provisions is illegal *per se.* It is also patent that a contract which is fair on its face is not unlawful in and of itself simply because it does not contain clauses prohibitory of illegal action."

The Court, in its remand, actually directed or suggested to the Board that it find from the facts, evidence of an intent upon the part of the signatories, of actual violation in practice.

This Court, in the *Mountain-Pacific* remand case, enunciated that the burden of proof is on the Government.

Admittedly, in this matter, if there is a short form agreement in existence, then this case must be dismissed.

Admittedly, there is such a short form agreement, and the burden to prove the contrary is on the Government, and this burden has not been met by the evidence; in fact, the evidence substantially establishes the existence of such a short form agreement and that the parties substantially abided by it, as indicated clearly by the payment by the employer, of health and welfare contributions.

IV.
Conclusion.

FROM THE FOREGOING FACTS AND LAW, AND BASED UPON THE ENTIRE RECORD IN THIS CASE, IT IS URGED THAT ENFORCEMENT BE DENIED THE NATIONAL LABOR RELATIONS BOARD IN THIS MATTER, AND THAT, UPON REVIEW OF THE ENTIRE RECORD, THE ACTION OF THE BOARD IN ITS DECISION AND ORDER BE REVERSED.

Dated: October 7, 1960.

Respectfully submitted,

ALEXANDER H. SCHULLMAN,
Attorney for Respondent Union.

No. 16732

United States
Court of Appeals
for the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

vs.

INTERNATIONAL HOD CARRIERS', BUILDING AND COMMON LABORERS' UNION OF AMERICA, LOCAL 300, AFL-CIO,
Respondent.

Transcript of Record

Petition for Enforcement and Petition for Review of Order of the National Labor Relations Board

Phillips & Van Orden Co., Fourth and Berry Sts., San Francisco, Calif.—5-17-60

No. 16732

United States
Court of Appeals
for the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

vs.

INTERNATIONAL HOD CARRIERS', BUILDING AND COMMON LABORERS' UNION OF AMERICA, LOCAL 300, AFL-CIO,
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

THOMAS J. McDERMOTT,
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MARCEL MALLET-PREVOST,
Assistant General Counsel,

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Washington 25, D. C.,

Attorneys for Petitioner.

ALEXANDER H. SCHULLMAN,
6505 Wilshire Boulevard,
Los Angeles 48, California,

Attorney for Respondent.

GENERAL COUNSEL'S EXHIBIT No. 1-A

United States of America
National Labor Relations Board

CHARGE AGAINST LABOR ORGANIZATION OR ITS AGENTS

* * * * *

Case No. 21-CB-1077. Date filed: 4-24-58.

1. Labor Organization or Its Agents Against Which Charge Is Brought:

Name: Laborers Local Union 300, AFL-CIO.

Address: 2005 West Pico Boulevard, Los Angeles 6, California.

The above-named organization or its agents have engaged in and are engaging in unfair labor practices within the meaning of Section 8(b) Subsections (1)(A) and (2) of the National Labor Relations Act, and these unfair labor practices are unfair labor practices affecting commerce within the meaning of the Act.

2. Basis of the charge:

The above-named Labor Organization, acting through its officers, agents, and employees, caused Martin Bros. to discharge the undersigned employees on April 21, 1958, because they were not cleared to work for the Employer by said Labor Organization.

By these and other acts, said Labor Organization has restrained and coerced the employees of Mar-

General Counsel's Exhibit No. 1-A—(Continued)

tin Bros. in their rights guaranteed in Section 7 of the Act.

3. Name of Employer: Martin Bros.

4. Location of plant involved: 6206 South Wilton Place, Los Angeles, California.

5. Type of establishment: Construction Contractor.

6. Identify principal product or service: Plastering and Lathing.

7. Number of workers employed: 15.

8. Full name of party filing charge: 1. Monico C. Garcia. 2. Jesse Gallego.

9. Address of party filing charge (Street, City, and State): 1. 2326 Riverside Drive, Los Angeles, California. 2. 672¼ La Mar, Los Angeles, California.

10. Telephone Number: 1. NO 2-4080. 2. CA 5-1837.

11. Declaration:

I declare that I have read the above charge and that the statements therein are true to the best of my knowledge and belief.

/s/ MONICO C. GARCIA
/s/ By JESSE GALLEGO
1. Monico C. Garcia
2. Jesse Gallego
Individuals

April 24, 1958.

Admitted in Evidence December 3, 1958.

GENERAL COUNSEL'S EXHIBIT No. 1-D

United States of America
Before the National Labor Relations Board
Twenty-First Region

Case No. 21-CB-1077

INTERNATIONAL HOD CARRIERS', BUILDING AND COMMON LABORERS' UNION OF AMERICA, LOCAL #300, AFL-CIO,

and

MONICO C. GARCIA AND JESSE GALLEGO, INDIVIDUALS.

COMPLAINT AND NOTICE OF HEARING

It having been charged by Monico C. Garcia and Jesse Gallego that International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO, herein called the Respondent, has been engaging in, and is engaging in, unfair labor practices affecting commerce as set forth and defined in the National Labor Relations Act, as amended, 61 Stat. 136, herein called the Act; the General Counsel of the National Labor Relations Board, herein called the Board, on behalf of the Board, by the undersigned Regional Director, issues this Complaint and Notice of Hearing pursuant to Section 10 (b) of the Act and Section 102.15 of the Board's Rules and Regulations, Series 7:

General Counsel's Exhibit No. 1-D—(Continued)

1. The charge was filed by Monico C. Garcia and Jesse Gallego on April 24, 1958, and was served upon the Respondent on April 25, 1958.

2. The Contracting Plasterers' Association of Southern California, Inc., herein called the Association, is an association of contractors in Southern California engaged in lathing and plastering work. Through designated representatives it participates in the negotiation and execution of collective bargaining agreements with various labor organizations, including the Respondent, on behalf of its members, including Martin Bros., more fully described in paragraph 3 below.

3. Martin Bros. is a partnership engaged in the lathing and plastering contracting business and is a member of the Association.

4. Members of the Association located in Southern California, during the 12-month period ending June 30, 1958, have shipped products and furnished services valued in excess of $50,000 to points outside the State of California.

5. The Association and its members, including Martin Bros., are engaged in commerce within the meaning of Section 2, subsections (6) and (7) of the Act.

6. The Respondent is a labor organization within the meaning of Section 2, subsection (5) of the Act.

7. The Respondent, by its representative, Dan Gomez, attempted to cause and did cause Martin Bros. to discharge Monico C. Garcia and Jesse

General Counsel's Exhibit No. 1-D—(Continued)

Gallego, on or about April 21, 1958, for reasons other than their failure to tender initiation fees and periodic dues uniformly required as a condition of acquiring or retaining membership.

8. By the acts and conduct set forth in paragraph 7 above, the Respondent has caused and is causing an employer to discriminate against employees in violation of Section 8 (a) (3) of the Act, and the Respondent thereby has engaged in and is engaging in unfair labor practices within the meaning of Section 8 (b), subsection (2) of the Act.

9. By the acts and conduct set forth in paragraph 7 above, the Respondent has restrained and coerced and is restraining and coercing employees in the exercise of the rights guaranteed in Section 7 of the Act, and has thereby engaged in and is engaging in unfair labor practices within the meaning of Section 8 (b), subsection (1) (A) of the Act.

10. The acts and conduct of the Respondent, as set forth in paragraphs 7, 8 and 9, occurring in connection with the operations of Martin Bros. and the Association, as described in paragraphs 2, 3 and 4 hereof, have a close, intimate and substantial relation to trade, traffic and commerce among the several states of the United States and have led and tend to lead to labor disputes burdening and obstructing commerce and the free flow of commerce as defined in Section 2, subsection (7) of the Act.

General Counsel's Exhibit No. 1-D—(Continued)

11. The acts and conduct of the Respondent, as set forth in paragraphs 7, 8 and 9 above, constitute unfair labor practices affecting commerce within the meaning of Section 2, subsections (6) and (7), and Section 8 (b), subsections (1) (A) and (2) of the Act.

Please Take Notice that on the 12th day of November 1958, at 10:00 a.m., PST, in Hearing Room 1, on the Mezzanine Floor, 849 South Broadway, Los Angeles, California, a hearing will be conducted before a duly designated Trial Examiner of the National Labor Relations Board on the allegations set forth in the above Complaint, at which time and place you will have the right to appear in person, or otherwise, and give testimony.

You are further notified that, pursuant to Sections 102.20 and 102.21 of the Board's Rules and Regulations, Respondent shall file with the undersigned Regional Director, acting in this matter as agent of the National Labor Relations Board, an original and four (4) copies of an answer to said Complaint within ten (10) days from the service thereof and that unless it does so all of the allegations in the Complaint shall be deemed to be admitted to be true and may be so found by the Board.

Wherefore, the General Counsel of the National Labor Relations Board, on behalf of the Board, by the undersigned Regional Director, this 21st day of

General Counsel's Exhibit No. 1-D—(Continued)

October 1958, issues this Complaint and Notice of Hearing against Respondent herein.

[Seal] /s/ RALPH E. KENNEDY,
Regional Director, National Labor Relations Board,
Twenty-First Region.

Admitted in Evidence December 3, 1958.

GENERAL COUNSEL'S EXHIBIT No. 1-F

[Title of Board and Cause.]

ANSWER TO COMPLAINT

Respondent in the above matter, through its counsel, Alexander H. Schullman, in answer to the complaint on file herein, admits, denies and alleges as follows:

1. Having no information or belief with respect to paragraph 1 of said complaint, respondent denies each and all of the allegations contained therein.

2. In answer to paragraph 4 of said complaint, having no information or belief with respect thereto, respondent denies each and all of the allegations contained therein.

3. In answer to paragraph 5 of said complaint, respondent denies that Martin Brothers is engaged in commerce within the meaning of Section 2, subsections (6) and (7) of the Act.

General Counsel's Exhibit No. 1-F—(Continued)

4. In answer to paragraph 7 of said complaint, respondent denies each and all of the allegations contained therein.

5. In answer to paragraph 8 of said complaint, respondent denies each and all of the allegations contained therein, and denies that it has caused an employer to discriminate against employees in violation of Section 8 (a) (3) of the Act, and further denies that respondent has engaged and is engaging in unfair labor practices within the meaning of Section 8 (b), subsection (2) of the Act.

6. In answer to paragraph 9 of said complaint, respondent denies each and all of the allegations contained therein and further denies that respondent has restrained and coerced or is restraining and coercing employees in the exercise of the rights guaranteed in Section 7 of the Act, and further denies that it has engaged in or is engaging in unfair labor practices under Section 8 (b), subsection (1) (A) of the Act.

7. Answering paragraph 10 of said complaint, respondent denies each and all of the allegations contained therein and further denies that any of the alleged acts or conduct of respondent have in any way a close, intimate and substantial relation to commerce among the several states of the United States and tend to lead to labor disputes burdening and obstructing commerce and the free flow of commerce as defined in Section 2, subsection (7) of the Act.

General Counsel's Exhibit No. 1-F—(Continued)

8. Answering paragraph 11 of said complaint, respondent denies all of the allegations contained therein and denies that the alleged acts and conduct of the respondent, as set forth in paragraphs 7, 8 and 9 of the complaint, constitute unfair labor practices affecting commerce within the meaning of Section 2, subsections (6) and (7), and Section 8 (b), subsections (1) (A) and (2) of the Act.

9. For an affirmative response, respondent alleges as follows:

(a) That Martin Brothers are presently and have been for some time under contract with respondent, and that employment pursuant to said contract and the procedures thereto have not been complied with, so that the employment by Martin Brothers of the charging parties has constituted unfair labor practice against respondent, its members and nonmembers who have appeared on the open and nondiscriminatory hiring hall lists maintained by respondent pursuant to its collective bargaining agreement with Martin Brothers.

(b) That the National Labor Relations Board does not have jurisdiction of the matters complained of, since each and all of such matters constitute matters that are intrastate and do not affect or burden commerce.

(c) That respondent having been deprived and denied, historically and legally, the rights and benefits of the remedial provisions of the Labor Management Relations Act, 1947, as amended, may not

General Counsel's Exhibit No. 1-F—(Continued)

be subject to or have invoked against it any of the sanctions or penalties provided for in said Act.

Wherefore, in behalf of the respondent, counsel for said respondent respectfully requests that the complaint be dismissed against respondent.

/s/ ALEXANDER H. SCHULLMAN
Alexander H. Schullman
Attorney for Respondent

Admitted in Evidence December 3, 1958.

[Title of Board and Cause.]

INTERMEDIATE REPORT AND RECOMMENDED ORDER

Statement of the Case

This complaint alleges that Respondent, International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO, caused Martin Bros., an employer, to discharge Monico C. Garcia and Jesse Gallego on or about April 21, 1958, for reasons other than their failure to tender initiation fees and periodic dues, thereby engaging in unfair labor practices within the meaning of Section 8 (b) (1) (A) and (2) of the Act. Respondent's answer denied the commission of any unfair labor practices; denied that commerce was affected herein; and alleged that Martin Bros. had

not complied with its contractual arrangement with Respondent providing for a hiring hall.

Pursuant to notice, a hearing was held before the undersigned Trial Examiner at Los Angeles, California, on December 3, 4, and 18, 1958. The parties were represented by counsel who were afforded full opportunity to be heard, to examine and cross-examine witnesses and to introduce relevant evidence. The General Counsel and Respondent presented oral argument and a time was set for filing briefs; no briefs were received within the set period.

Upon the entire record in the case, and from my observation of the witnesses, I make the following:

Findings of Fact

I. The business of the Employer

Martin Bros., a partnership engaged in lathing and plastering contracting in the Los Angeles area, is a member of the Contracting Plasterers' Association of Southern California, Inc., whose members consist of 326 lathing and plastering contractors in Orange and Los Angeles Counties, California. The latter bargains for and signs association-wide collective bargaining agreements in behalf of all its members with various labor organizations including Respondent. During the year ending June 30, 1958, one member of the Association, A. E. Eiden and Sons, of Los Angeles, performed work valued between $600,000 and $750,000 at the Air Force

Academy in Colorado Springs, Colorado; the total price of this contract was $1,586,000.[1]

I find that the operations of Martin Bros. affect commerce and that it would effectuate the purposes of the Act to assert jurisdiction herein. Siemons Mailing Service, 122 NLRB No. 13; Local 27, ITU (Heiter-Starke Printing Co.) 121 NLRB No. 131; and Insulation Contractors of Southern California, 110 NLRB 638. See also N. L. R. B. v. Gottfried Baking Co., 210 F. 2d 772 (C.A. 2); N. L. R. B. v. Drummond Implement Co., 210 F. 2d 828 (C.A. 6); and N. L. R. B. v. Weyerhaeuser Timber Company, 132 F. 2d 234 (C.A. 9).

II. The labor organization involved

International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO, is a labor organization admitting to membership the employees of the employer.

III. The unfair labor practices

A. The issue; sequence of events

The sole issue herein is whether Respondent Union caused the discharge by the employer of two employees, Monico C. Garcia and Jesse Gallego, on Monday, April 21, 1958, for a reason not permitted under the Act. The facts in great part are not in dispute.

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[1] The transcript erroneously omitted a cipher in the last figure. It is further noted that the transcript erroneously refers to Garcia as Garcio.

The employer has been engaged for some time on a construction project known as the Wilshire Terrace job. The two complainants, of their own volition, went to the project on Friday, April 18; solicited employment from Foreman Arthur Sherman; and were hired as laborers. Both were members in good standing of Respondent at the time material herein and Garcia had been a member for 16 months. No issue has been raised with respect to their good standing.

The two men also reported for work on the next workday, Monday, April 21, but were not permitted to commence work. Assistant Business Agent Gomez of Respondent was on the scene; ascertained that the men had found this employment themselves without a union clearance; and then spoke with Foreman Sherman in the presence of the two complainants. According to Sherman, Gomez announced that "these men have to get off the job because they have no clearance for the job." Sherman immediately instructed the two men to report to the local hiring hall "and get a clearance and come back." According to Garcia, Sherman told them to "go get it straight with the union."

Obtaining a clearance was not a simple matter, however. The two men left the job, reported to the union hall and were referred to Acting Field Manager Joseph D'Amico who was not in. They waited for his return at approximately 2 p.m. and at that time D'Amico refused to give them a clearance. The two men protested that they had jobs waiting for

them and needed the clearance, but D'Amico replied that they had to list their numbers on the referral board and wait for their turn. The two men also approached Dispatcher Dan Harvey but were met with the same response; indeed Harvey pointed out that he had sent two other men to the job.

About 7 weeks later, the two men did go back to work at the Wilshire Terrace job, apparently pursuant to the dispatch system, and Garcia is currently employed there. During the interim, they attempted twice on their own to obtain reinstatement, but were refused work by Foreman Sherman because they did not have a clearance. It is to be noted that Garcia reported to the hall each morning during this period and listed his name, but was not dispatched to any jobs.

B. Conclusions

A recitation of the facts readily discloses that there is an undisputed violation of the Act unless Respondent's defenses have merit. Contrary to Respondent's contention, direct action was taken against specific individuals by Respondent and this constitutes causation within the meaning of Section 8 (b) (2) of the Act. Westwood Plumbers, 122 NLRB No. 91.

As for the merits, Board decisions recognize two avenues of approach by way of defense. Firstly, if there is a valid union shop, discharges only for failure to pay periodic dues or initiation fees are recognized under the authority of N. L. R. B. vs.

Radio Officers Union, 347 U.S. 17. Respondent's defense does not appear to be directed to this; if it were, it would fail for this case involves the imposition of a greater degree of union security than the Act permits.

Secondly, and more currently, the Board will recognize an exclusive hiring hall agreement between employer and a union, usually in a situation where the contract has no union shop clause, where three specific safeguards against discrimination are set up, as provided in Mountain Pacific Chapter of the AGC, 119 NLRB No. 126-A. See, e.g., Local Union No. 450, International Union of Operating Engineers, AFL-CIO (Tellepsen), 122 NLRB No. 78, and E&B Brewing Company, Inc., 122 NLRB No. 50. Perhaps still a third avenue of approach appears to be one where, despite the existence of a hiring hall and the absence of a union shop contract, the union refuses to dispatch for reasons that the Board has found to be unrelated to union activities. Longshoremen's Local No. 10, 121 NLRB No. 60.

Respondent's contention in this case is apparently bottomed upon the second of the foregoing categories. It claims that Respondent and the employer, Martin Bros., are subject to a hiring hall clearance system. The facts do not bear this out. Initially, it is clear, as Partner William Martin testified, that Martin Bros. uses both plaster tenders and laborers; that Martin Bros., through its membership in the Contracting Plasters' Association, is party to a contract with Respondent; and that this

contract applies to plaster tenders only. This contractual relationship is of long standing and involves the dispatch of plaster tenders through Respondent's hiring hall.

However Respondent contends that a similar arrangement also covers the employment of laborers by Martin Bros. It relies on the following facts. In 1946 when W. L. Martin was in business for himself he did some general contracting work involving the use of various basic crafts and he thus found it necessary to obtain a general contractor's license. Although never a member of the Associated General Contractors, he signed a so-called short form agreement in June of 1946 with the Los Angeles Building and Construction Trades Council.

Therein he agreed on a one-page document, inter alia, (1) to employ "only members in good standing" of the respective labor organizations belonging to the Building Trades Council and (2) to contact the Building Trades Council before starting jobs and complying with its requirements for "clearing workmen to the job." The agreement is silent concerning wages, hours, and other basic working conditions. It is Respondent's theory that this agreement which ran for one year and from year to year thereafter has kept renewing itself; is currently in effect; and that as a result, Martin Bros., which was first formed in 1948, it may be noted, is bound by existing contracts in the Los Angeles area between various employer groups and the District Council of Laborers, which presumably includes Respondent Union.

Respondent's contention in this respect comes as a surprise to the Contracting Plasterers' Association, the bargaining representative of Martin Bros. For its executive secretary, William Colhoun, testified that it bargains in behalf of its 326 members with Respondent, that it has but one contract with Respondent, and that this, as noted, applies only to hod carriers [plaster tenders]. Specifically, he testified that the Association and its members have no agreement with Respondent for laborers.

Respondent points to the admitted fact that Martin Bros. does hire laborers through Respondent's hiring hall and further that it makes contributions to the health and welfare fund for both plaster tenders and laborers; these are separate funds under separate trusteeship. That is, the labor contracts in the Los Angeles area call for contributions of so much per hour worked to health and welfare funds for both plaster tenders and laborers, and Martin Bros. makes these contributions; the contributions to the laborers fund have been made since 1955.

On the other hand, this conduct by Martin Bros. is equally consistent with an employer acting in a manner consistent with the realities of industrial life. The Union wage scale in the area apparently called for so much per hour plus fringe benefits and partner William Martin testified that he pays laborers' wages as set forth in the current A.G.C. contract in the area. In order to obtain union employees through the Union he presumably paid the scale and fringe benefits prevailing in this large

metropolitan area. And the record discloses that Martin Bros. has hired directly on the job in a number of cases as well as through the Union.

To sum up, a preponderance of the evidence supports the claim of the General Counsel that there was no contract or contractual arrangement between Martin Bros. and Respondent Union covering the dispatch of laborers. The only evidence of a contract, aside from the contributions to the health and welfare fund, is a one-page short form document signed in 1946 by the predecessor of Martin Bros., whereby the predecessor agreed to maintain an illegal closed shop in his dealings with the six basic trades which were members of the Building Trades Council.

Obviously, this one page document which sets forth no wages, rates of pay, hours of employment, or customary terms and conditions of employment does not rise to the stature of a collective bargaining agreement, particularly so 12 years after its signature by a different employer. Merritt-Chapman & Scott, 118 NLRB 380, 382. Furthermore it goes beyond the limited union shop permitted under the Radio Officers decision, supra. And considering it under the Board's Mountain Pacific doctrine, supra, that the hiring hall is sui generis and to be evaluated under its own criteria, the record does not disclose that Respondent has met the three requisites of the Mountain Pacific decision. See Consolidated Western Steel, 122 NLRB No. 107.

In view of all the foregoing considerations, I find that Respondent caused the discharge, on April 21,

1958, of Monico Garcia and Jesse Gallego; that by such conduct, Respondent has engaged in unfair labor practices within the meaning of Section 8 (b) (2) of the Act, and further that Respondent has thereby restrained and coerced employees in the exercise of the rights guaranteed by Section 7 of the Act, within the meaning of Section 8 (b) (1) (A) thereof.

IV. The effect of the unfair labor practices upon commerce

The activities of Respondent, set forth in Section III above, occurring in connection with the operations of the employer, described in Section I above, have a close, intimate and substantial relation to trade, traffic, and commerce among the several States and tend to lead to labor disputes burdening and obstructing commerce and the free flow thereof.

V. The remedy

Having found that Respondent has engaged in unfair labor practices, I shall recommend that it cease and desist therefrom and take certain affirmative action designed to effectuate the policies of the Act.

It has been found that Respondent caused Martin Bros. to discriminate against Monico C. Garcia and Jesse Gallego. Although the record discloses that Garcia has returned to work for the Employer, it does not reveal whether Gallego has. It will be recommended therefore that Respondent notify the

Employer, in writing, and furnish copies thereof to Garcia and Gallego, that it withdraws its objections to their employment and requests the Employer to offer Gallego reinstatement. It will further be recommended that Respondent make them whole for any loss of pay suffered by reason of the discrimination against them. Said loss of pay, based upon earnings which they would normally have earned from the date of the discrimination against them, April 21, 1958 to the date of reinstatement or offer thereof, as the case may be, less net earnings, shall be computed in the manner established by the Board in F. W. Woolworth Company, 90 NLRB 289. See N. L. R. B. v. Seven-Up Bottling Co., 344 U.S. 344.

Upon the basis of the foregoing findings of fact, and upon the entire record in the case, I make the following:

Conclusions of Law

1. Martin Bros. is engaged in commerce within the meaning of Section 2 (6) and (7) of the Act.

2. International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO, is a labor organization within the meaning of Section 2 (5) of the Act.

3. By causing an employer to discriminate against Monico C. Garcia and Jesse Gallego in violation of Section 8 (a) (3) of the Act, Respondent has engaged in unfair labor practices within the meaning of Section 8 (b) (2) of the Act.

4. By the foregoing conduct, Respondent has restrained and coerced employees in the exercise of the rights guaranteed in Section 7 of the Act, thereby engaging in unfair labor practices within the meaning of Section 8 (b) (1) (A) of the Act.

5. The aforesaid unfair labor practices are unfair labor practices affecting commerce within the meaning of Section 2 (6) and (7) of the Act.

Recommendations

Upon the basis of the foregoing findings of fact and conclusions of law, I recommend that Respondent, International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO, its officers, representatives, agents, successors and assigns, shall:

1. Cease and desist from:

(a) Causing or attempting to cause Martin Bros. or any employer whose operations affect commerce, to discriminate against employees in violation of Section 8 (a) (3) of the Act;

(b) Restraining or coercing employees in the exercise of the rights guaranteed by Section 7 of the Act, except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment, as authorized in Section 8 (a) (3) of the Act.

2. Take the following affirmative action which I find will effectuate the policies of the Act:

(a) Make whole Monico C. Garcia and Jesse Gallego for any loss of pay they may have suf-

fered by reason of the discrimination against them in the manner set forth hereinabove.

(b) Notify Monico C. Garcia, Jesse Gallego and Martin Bros., in writing, that it withdraws its objections to the employment of Garcia and Gallego and requests Martin Bros. to offer Gallego reinstatement.

(c) Post at its business office and at all places where notices to members are customarily posted, in conspicuous places, copies of the notice attached hereto as Appendix A. Copies of said notice, to be furnished by the Regional Director for the Twenty-first Region, shall, after being duly signed by Respondent's representative, be posted by it immediately upon receipt thereof and maintained for sixty (60) consecutive days thereafter. Reasonable steps shall be taken by Respondent to insure that said notices are not altered, defaced, or covered by any other material;

(d) Mail to the Regional Director for the Twenty-first Region signed copies of the notice attached hereto as Appendix A for posting at the construction sites of Martin Bros., within the jurisdiction of Respondent, the Employer willing, for sixty (60) consecutive days in places where notices to employees are customarily posted;

(e) Notify the Regional Director for the Twenty-first Region in writing within twenty (20) days from the receipt of this Intermediate Report and Recommended Order what steps it has taken to comply herewith.

It is further recommended that unless Respondent shall within twenty (20) days from the date of receipt of this Intermediate Report and Recommended Order notify the aforesaid Regional Director in writing that it will comply with the foregoing recommendations, the National Labor Relations Board issue an order requiring it to take the aforesaid action.

Dated this 27th day of January 1959.

/s/ MARTIN S. BENNETT,
Trial Examiner.

APPENDIX A

Notice to All Employees of Martin Bros. and to All Members of International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO: Pursuant to the Recommendations of a Trial Examiner of the National Labor Relations Board, and in order to effectuate the policies of the National Labor Relations Act, we hereby notify you that:

We Will make whole Monico C. Garcia and Jesse Gallego for any loss of pay suffered as a result of the discrimination against them.

We Will notify Martin Bros., Monico C. Garcia and Jesse Gallego in writing that we withdraw our

objections to the employment of Garcia and Gallego and request the reinstatement of Gallego to his former or an equivalent position.

We Will Not cause or attempt to cause Martin Bros. or any other employer whose operations affect commerce to discriminate against any employee in violation of Section 8 (a) (3) of the Act.

We Will Not restrain or coerce employees in the exercise of the rights guaranteed by Section 7 of the Act, except to the extent that such rights may be affected by an agreement executed in conformity with Section 8 (a) (3) of the Act.

International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO

(Labor Organization)

Dated.....

By .....

(Representative) (Title)

This notice must remain posted for 60 days from the date hereof, and must not be altered, defaced, or covered by any other material.

United States of America
Before the National Labor Relations Board

Case No. 21-CB-1077

INTERNATIONAL HOD CARRIERS', BUILDING AND COMMON LABORERS' UNION OF AMERICA, LOCAL #300, AFL-CIO, (MARTIN BROS.)

and

MONICO C. GARCIA AND JESSE GALLEGO, INDIVIDUALS.

DECISION AND ORDER

On January 27, 1959, Trial Examiner Martin S. Bennett issued his Intermediate Report in the above-entitled proceeding, finding that the Respondent had engaged in and was engaging in certain unfair labor practices and recommending that it cease and desist therefrom and take certain affirmative action, as set forth in the copy of the Intermediate Report attached hereto. Thereafter, the Respondent filed exceptions to the Intermediate Report and a supporting brief.[1]

The Board has reviewed the rulings made by the Trial Examiner at the hearing and finds that no prejudicial error was committed. The rulings are

[1] The Respondent has requested oral argument. This request is hereby denied because the record, the exceptions, and the brief adequately present the issues and the positions of the parties.

hereby affirmed. The Board has considered the Intermediate Report, the exceptions and brief, and the entire record in the case, and hereby adopts the findings, conclusions, and recommendations of the Trial Examiner.

Order

Upon the entire record in this case, and pursuant to Section 10 (c) of the National Labor Relations Act, as amended, the National Labor Relations Board hereby orders that International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO, its officers, representatives, agents, successors and assigns, shall:

1. Cease and desist from:

(a) Causing or attempting to cause Martin Bros., to discriminate against employees in violation of Section 8 (a) (3) of the Act;

(b) In any other manner restraining or coercing employees in the exercise of the rights guaranteed by Section 7 of the Act, except to the extent that such rights may be affected by an agreement requiring membership in a labor organization as a condition of employment, as authorized in Section 8 (a) (3) of the Act.

2. Take the following affirmative action which the Board finds will effectuate the policies of the Act:

(a) Make whole Monico C. Garcia and Jesse

Gallego for any loss of pay they may have suffered by reason of the discrimination against them, according to the method prescribed in Section V of the Intermediate Report, entitled "The Remedy;"

(b) Notify Monico C. Garcia, Jesse Gallego, and Martin Bros., in writing, that it withdraws its objections to the employment of Garcia and Gallego and requests Martin Bros. to offer Gallego reinstatement;

(c) Post at its business office and at all places where notices to members are customarily posted, in conspicuous places, copies of the notice attached to the Intermediate Report as Appendix A.[2] Copies of said notice, to be furnished by the Regional Director for the Twenty-first Region, shall, after being duly signed by Respondent's representative, be posted by it immediately upon receipt thereof and maintained for sixty (60) consecutive days thereafter. Reasonable steps shall be taken by Respondent to insure that said notices are not altered, defaced, or covered by any other material;

---

[2] This notice shall be amended by substituting for the words "The Recommendations of a Trial Examiner" the words "A Decision and Order." In the event this Order is enforced by a decree of a United States Court of Appeals, the notice shall be further amended by substituting for the words "Pursuant to a Decision and Order" the words "Pursuant to a Decree of the United States Court of Appeals, Enforcing an Order."

(b) Mail to the Regional Director for the Twenty-first Region signed copies of the aforementioned notice for posting at the construction sites of Martin Bros., within the jurisdiction of Respondent, the Employer willing, for sixty (60) consecutive days in places where notices to employees are customarily posted;

(e) Notify the Regional Director for the Twenty-first Region, in writing, within ten (10) days from the date of this Order, as to what steps Respondent has taken to comply therewith.

Dated, Washington, D. C., May 20, 1959.

BOYD LEEDOM, Chairman,
PHILIP RAY RODGERS,
Member,
JOSEPH ALTON JENKINS,
Member,
STEPHEN S. BEAN, Member,
JOHN H. FANNING, Member,
[Seal] National Labor Relations Board.

United States Court of Appeals
for the Ninth Circuit

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

vs.

INTERNATIONAL HOD CARRIERS', BUILDING AND COMMON LABORERS' UNION OF AMERICA, LOCAL #300, AFL-CIO,
Respondent.

CERTIFICATE OF THE NATIONAL LABOR RELATIONS BOARD

The National Labor Relations Board, by its Executive Secretary, duly authorized by Section 102.92, Rules and Regulations of the National Labor Relations Board—Series 7, hereby certifies that the documents annexed hereto constitute a full and accurate transcript of the entire record of a proceeding had before said Board and known upon its records as Case No. 21-CB-1077. Such transcript includes the pleadings and testimony and evidence upon which the order of the Board in said proceeding was entered, and includes also the findings and order of the Board.

Fully enumerated, said documents attached hereto are as follows:

1. Stenographic transcript of testimony taken before Trial Examiner Martin S. Bennett on De-

cember 3, 4 and 18, 1958, together with all exhibits introduced in evidence at the hearing.

2. Copy of Trial Examiner Bennett's Intermediate Report and Recommended Order dated January 27, 1959 (annexed to item 4 below).

3. Respondent's exceptions to the Intermediate Report received March 16, 1959, together with request for oral argument. (Oral argument request denied. See Footnote 1, page 1 of Decision and Order.)

4. Copy of Decision and Order issued by the National Labor Relations Board on May 20, 1959, with Intermediate Report and Recommended Order annexed.

5. Respondent's motion for reconsideration, and to set aside the order of the Board and to reopen the case for additional testimony, received August 11, 1959.

6. Copy of Order denying motion issued by the National Labor Relations Board on September 4, 1959.

In Testimony Whereof, the Executive Secretary of the National Labor Relations Board, being thereunto duly authorized as aforesaid, has hereunto set his hand and affixed the seal of the National Labor Relations Board in the city of Washington, District of Columbia, this 8th day of February, 1960.

[Seal] /s/ FRANK M. KLEILER,
Executive Secretary, National
Labor Relations Board.

[Endorsed]: No. 16732. United States Court of Appeals for the Ninth Circuit. National Labor Relations Board, Petitioner, vs. International Hod Carriers', Building and Common Laborers' Union of America, Local 300, AFL-CIO, Respondent. Transcript of Record. Petition for Enforcement and Petition for Review of Order of the National Labor Relations Board.

Filed: February 15, 1960.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

No. 16732

NATIONAL LABOR RELATIONS BOARD,
Petitioner,

vs.

INTERNATIONAL HOD CARRIERS', BUILDING AND COMMON LABORERS' UNION OF AMERICA, LOCAL #300, AFL-CIO,
Respondent.

PETITION FOR ENFORCEMENT OF AN ORDER OF THE NATIONAL LABOR RELATIONS BOARD

To the Honorable, the Judges of the United States Court of Appeals for the Ninth Circuit:

The National Labor Relations Board, pursuant to the National Labor Relations Act, as amended

(61 Stat. 136, 29 U. S. C., Secs. 151, et seq., as amended by 72 Stat. 945), hereinafter called the Act, respectfully petitions this Court for the enforcement of its Order against International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO, its officers, representatives, agents, successors and assigns. The proceeding resulting in said order is known upon the records of the Board as Case No. 21-CB-1077.

In support of this petition the Board respectfully shows:

(1) Respondent is a labor organization engaged in promoting and protecting the interests of its members in the State of California within this judicial circuit where the unfair labor practices occurred. This Court therefore has jurisdiction of this petition by virtue of Section 10 (e) of the National Labor Relations Act, as amended.

(2) Upon due proceedings had before the Board in said matter, the Board on May 20, 1959, duly stated its findings of fact and conclusions of law, and issued an Order directed to the Respondent, its officers, representatives, agents, successors and assigns. On the same date, the Board's Decision and Order was served upon Respondent by sending a copy thereof postpaid, bearing Government frank, by registered mail, to Respondent's counsel.

(3) Pursuant to Section 10 (e) of the National Labor Relations Act, as amended, the Board is certifying and filing with this Court a transcript

of the entire record of the proceeding before the Board upon which the said Order was entered, which transcript includes the pleadings, testimony and evidence, findings of fact, conclusions of law, and the Order of the Board sought to be enforced.

Wherefore, the Board prays this Honorable Court that it cause notice of the filing of this petition and transcript to be served upon Respondent and that this Court take jurisdiction of the proceeding and of the questions determined therein and make and enter upon the pleadings, testimony and evidence, and the proceeding set forth in the transcript and upon the Order made thereupon a decree enforcing in whole said order of the Board, and requiring Respondent, its officers, representatives, agents, successors and assigns to comply therewith.

Dated at Washington, D. C., this 30th day of December, 1959.

/s/ THOMAS J. McDERMOTT,
Associate General Counsel, National Labor Relations Board.

[Endorsed]: Filed January 5, 1960. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Cause.]

ANSWER BY RESPONDENT TO PETITION FOR ENFORCEMENT OF THE NATIONAL LABOR RELATIONS BOARD AND REQUESTING REVIEW AND SETTING ASIDE OF THE ORDER OF THE NATIONAL LABOR RELATIONS BOARD

To the Honorable, the Judges of the United States Court of Appeals for the Ninth Circuit:

International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO, Respondent, in answer to the petition for enforcement of an order of the National Labor Relations Board filed by the General Counsel for the Board, with this Honorable Court, alleges as follows:

1. Admits the allegations of Paragraph 1 of said petition and admits that this Court has jurisdiction by virtue of Section 10(e) of the National Labor Relations Act as amended.

2. In answer to Paragraph 2 of said petition, Respondent denies that, in essence, due proceedings had been had before the Board in that as part of said proceedings a hearing was held before a trial examiner who made his intermediate report and recommended order some time in January of 1959, to which Respondent filed its Exceptions and brief with the National Labor Relations Board contending, inter alia, that interstate commerce was not involved or could be affected in this matter since

the employer was not engaged in interstate commerce within the meaning of the Act; and further contended that the rulings of the trial examiner were in violation of law and in violation of the Act itself; Respondent admits that on or about May 20, 1959, the Board did state its Findings of Fact and Conclusions of Law and issued an order directed to Respondent. Respondent further admits service of said proceedings as alleged in said Paragraph 2 of its petition.

3. Respondent assumes that the Board will proceed and file the transcript as set forth in said Paragraph 3 of said petition.

4. In further answer of said petition, Respondent alleges as follows:—

A. That the Findings of Fact and Conclusions of Law made by the Board are not supported by substantial evidence on the record considered as a whole.

B. That the Order of the Board in this matter affirming the rulings of the trial examiner, finding that Respondent has committed unfair labor practices within the meaning of Section 8 (b)(1)(A) of the Act is not supported by a substantial evidence on record considered as a whole and further is contrary to law.

C. The Board, in issuing said Order, abused its discretionary power by requiring Respondent to comply therewith, in that a substantial and overwhelming evidence on the record considered as a whole establishes the following:—

(1) The National Labor Relations Board has no jurisdiction in this matter in that interstate commerce is not involved or affected;

(2) That the union acting pursuant to a valid, existing and written agreement did not commit any unfair labor practice within the meaning of the Act in requiring registrations to be made by employees on its open and non-discriminatory registration lists;

(3) The Order of the Board in this case, affirming as it does, the intermediate report of the trial examiner requires this entire case to be reviewed by this Court because of the exclusion of testimony by the trial examiner, and his subsequent Findings of Fact and Conclusions of Law which were based on such excluded testimony.

5. Pursuant to the above allegations, and based thereon and based upon the entire record which is being certified and filed with this Honorable Court by the National Labor Relations Board, Respondent herein respectfully requests that the entire record and case be reviewed and upon said review that the Order of the Board of May 20, 1959 be set aside, and as contrary to the substantial evidence on the record considered as a whole, and contrary to law.

Wherefore, Respondent herein respectfully prays that this Honorable Court review this entire case and upon such review and upon the entire transcript, make an Order and Decree setting aside the whole Order of the Board and requiring the Board to find and enter its Order that Respondent has not committed any unfair labor practice in the in-

stant case, and that the instant case should be dismissed with prejudice.

Dated at Los Angeles, California, this 18th day of January, 1960.

ALEXANDER H. SCHULLMAN,
Attorney for Respondent International Hod Carriers', Building and Common Laborers' Union of America, Local #300, AFL-CIO.

Affidavit of Service by Mail Attached.

[Endorsed]: Filed January 19, 1960. Frank H. Schmid, Clerk.

[Title of Court of Appeals and Cause.]

STATEMENT OF POINTS RELIED UPON BY THE BOARD

To the Honorable, the Judges of the United States Court of Appeals for the Ninth Circuit:

Comes now the National Labor Relations Board, petitioner herein, and pursuant to Rule 17 (6) of the rules of this Court, files this statement of points upon which it intends to rely in the above-entitled proceeding, and this designation of parts of the record necessary for the consideration thereof:

I.

Statement of Points

1. Substantial evidence on the record as a whole supports the Board's finding that respondent violated Sections 8 (b) (2) and (1) (A) of the Act when it caused Martin Brothers, an employer, to

discharge employees Monico C. Garcia and Jesse Gallego.

2. The Board properly found that the unfair labor practices affected commerce within the meaning of the Act.

Dated at Washington, D. C., this 8th day of February, 1960.

/s/ MARCEL MALLET-PREVOST,
Assistant General Counsel, National Labor Relations Board.

[Endorsed]: Filed February 10, 1960. Frank H. Schmid, Clerk.

Before the National Labor Relations Board
Twenty-First Region

Case No. 21-CB-1077

INTERNATIONAL HOD CARRIERS', BUILDING AND COMMON LABORERS' UNION OF AMERICA, LOCAL 300, AFL-CIO,

and

MONICO C. GARCIA AND JESSE GALLEGO, INDIVIDUALS.

TRANSCRIPT OF PROCEEDINGS

849 South Broadway, Los Angeles, California, December 3, 1958.

Pursuant to notice, the above-entitled matter came on for hearing at 10:00 o'clock a.m.

Before: Martin S. Bennett, Esq., Trial Examiner.

Appearances: Alexander H. Schullman, Esq., 6505 Wilshire Boulevard, Room 511, Los Angeles, California, appearing on behalf of International Hod Carriers', Building and Common Laborers' Union of America, Local 300, AFL-CIO. Mantalica, Barclay & Teegarden, by Louis N. Mantalica, Esq., 257 South Spring Street, Los Angeles 12, California, appearing on behalf of Contracting Plasterers Association. Ben Grodsky, Esq., 849 South Broadway, Los Angeles, California, appearing on behalf of General Counsel. [1]*

* * * * *

WILLIAM COLHOUN

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Grodsky): What is your position, Mr. Colhoun?

A. I am the executive secretary of the Contracting Plasterers Association, 417 South Hill Street.

Q. What type of employers are members of that Association? [13]

* * * * *

The Witness: They are lathing and plastering contractors employed in Orange and Los Angeles Counties exclusively.

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* Page numbers appearing at top of page of Reporter's Transcript of Record.

(Testimony of William Colhoun.)

Q. And does the Association engage in collective bargaining on behalf of its members?

A. It does.

Q. Does it have any collective bargaining agreements with laborers, Local No. 300?

A. It does.

Q. Does it have one agreement for one type or class of work or for more than one type or class of work? A. Just for hod carriers.

Q. And let me ask it negatively; does the Association or its members through the Association have any agreement for general laborers?

A. No, they do not.

Trial Examiner: Is this an Association-wide contract?

The Witness: Yes, sir.

Trial Examiner: Only one copy is signed?

The Witness: That's right.

Trial Examiner: And the various employers who belong to the Association are bound by that contract? [14]

The Witness: They are bound by that contract; after the contract is drawn, it is printed and distributed to both the unions and the employers.

Trial Examiner: Is this an annual contract?

The Witness: Yes.

Q. (By Mr. Grodsky): Among the members of your Association, you have Martin Brothers as a member? A. We do.

Q. And is A. E. Eiden and Sons a member?

A. They are. [15]

* * * * *

JACK EIDEN

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Grodsky): What is the nature of your business, Mr. Eiden?

A. We are plastering contractors.

Q. You say, "we," will you state with whom you are associated?

A. A. E. Eiden and Sons.

Q. Are you a member of the firm?

A. Yes.

Q. Is it a partnership?

A. No, it is a corporation. [18]

Q. Are you an officer of the corporation?

A. Yes, I am vice-president.

Q. Mr. Eiden, are you a member of the Contracting Plasterers Association of Southern California, Inc.?

A. Well, our corporation is, yes.

Q. Yes, and does your—has your firm engaged in any out-of-state work during the period, say, during the one-year period ending June 30, 1958?

A. We have done work at the Air Force Academy in Colorado Springs.

Trial Examiner: Did you say where you main office was?

The Witness: It is in Los Angeles.

(Testimony of Jack Eiden.)

Q. (By Mr. Grodsky): What was the value of that work during the 12-month period ending June 30, 1958?

A. Well, one of the contracts I brought along is for *$1,58,600.00,* and the period you are talking about is from July 1, 1957 to June 30, 1958, and approximately 60 to 70 per cent of the contract was done within that period.

Q. So that somewhere between $600,000.00 and $750,000.00 worth of work was in that period?

A. Right.

Trial Examiner: How long have you been a member of the Contracting Plasterers Association?

The Witness: It has been several years, I don't know the exact date. [19]

* * * * *

Trial Examiner: I had meant to ask Mr. Colhoun one question. Perhaps counsel can agree on it as to the approximate number of members in the Association?

Mr. Colhoun: 326.

* * * * *

MONICO C. GARCIO

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Grodsky): Are you a member of a labor organization? A. Yes, sir.

(Testimony of Monico C. Garcio.)

Q. What union? A. Local No. 300. [21]

Q. That is laborers? A. Laborers, yes.

Q. What kind of work do you do?

A. I am a laborer.

Q. General labor work? A. Yes.

Q. You are not a hod carrier? A. No, sir.

Q. You don't do any hod carrying?

A. No, sir.

Q. Did you ever work for Martin Brothers on the Wilshire Terrace job? A. Yes, sir.

* * * * *

Q. (By Mr. Grodsky): When is the first time that you worked on that job?

A. I worked 18 April, 1958, on Friday.

Q. And when is the next time that you came there to go to work?

A. The 21st in April. [22]

Q. That is a Monday? A. Yes, sir.

Q. Did you start to work on that day?

A. No, sir, the business agent come and told me to get a clearance to go to work.

Trial Examiner: Who is the business agent?

The Witness: Dan Gomez.

Mr. Schullman: Who?

Mr. Grodsky: It is Dan Gomez.

Trial Examiner: What did he tell you?

The Witness: He told me to come to a main office and get a clearance to go back to work.

Q. (By Mr. Grodsky): Who was present when Mr. Gomez and you had your conversation?

A. The foreman, Art, and Jesse Gallego.

(Testimony of Monico C. Garcio.)

Q. Is that Art Sherman? A. Yes, sir.

Q. Now, what was the first thing that Mr. Gomez said to you, do you remember?

A. He told me to come down to the main office and get a clearance. [23]

* * * * *

Trial Examiner: Do you know how he happened to tell you to go get a clearance?

The Witness: He told me to go to talk to Joe D'Amico and get a clearance.

Mr. Schullman: That is the gentleman who is absent, Joe D'Amico.

Q. (By Mr. Schullman): Why did he tell you to go get a clearance?

A. Because I don't have any.

Trial Examiner: You didn't have any clearance when he told you to get one?

The Witness: No, sir.

Q. (By Mr. Schullman): All right, did the foreman say anything? [24]

A. He told me to go get the clearance and then get my job back.

Triaal Examiner: This is Art Sherman?

The Witness: Yes, sir.

Trial Examiner: How long had you been working there?

The Witness: I was working one day, that was Friday.

Trial Examiner: Friday, the 18th?

The Witness: Yes, sir, then Monday he stopped me.

(Testimony of Monico C. Garcio.)

Trial Examiner: You said you are a member of the union?

The Witness: Yes, sir.

Trial Examiner: How long have you been a member of the union?

The Witness: About a year and 4 months.

Q. (By Mr. Grodsky): Did you go to the Union Hall? A. Yes, sir.

Q. Where is the Union Hall located?

A. On Pico Boulevard.

Q. That is 2005 Pico? A. Yes, sir.

Q. And who did you speak to first?

A. I stopped at the information window and they told me to go to the next floor and talk to Joe D'Amico. Joe D'Amico wasn't in in the morning and I had to wait until 2:00 in the afternoon, and I talked to him and he refused to give me the clearance. [25]

Q. Now, first of all, who was there when you talked to D'Amico? You were there and D'Amico was there; was anybody else there?

A. Jesse Gallego.

Q. Was anybody else there in addition?

A. No, sir.

Trial Examiner: You and Jesse went to the Union Hall together?

The Witness: Yes, sir.

Q. (By Mr. Grodsky): All right, now, can you tell us what you said to Mr. D'Amico and what Mr. D'Amico said to you?

(Testimony of Monico C. Garcio.)

A. Well, I told him I got a job and I need a clearance to go back to work, and he told me I had to put my number on the board and I had to wait until my turn come, so he say he can do nothing at all, so I go down and talk to Ben Harvey and he told me the same thing, they said they sent two men already to work for Martin Brothers.

Trial Examiner: Did you and Jesse go down and talk to Ben?

The Witness: Yes, sir.

Q. (By Mr. Grodsky): That is Dan Harvey; is that correct?

Mr. Colhoun: Yes.

Q. (By Mr. Grodsky): What was the position of Mr. Harvey at that time?

A. He was in the dispatching office. [26]

Trial Examiner: You said you asked for a clearance from Mr. D'Amico?

The Witness: Yes, sir.

Trial Examiner: How about Jesse?

The Witness: Both, we asked both.

Trial Examiner: You both asked?

The Witness: Yes, sir.

Trial Examiner: Did you both ask Dan Harvey?

The Witness: Dan Harvey, yes.

Trial Examiner: What was it Dan Harvey told you?

The Witness: He told me they sent already two men to work.

Trial Examiner: Is that all he said?

(Testimony of Monico C. Garcio.)

The Witness: Yes, and I told him I got the job and he should give me a clearance.

Trial Examiner: You told him you had the job if he would give you a clearance?

The Witness: Yes, sir.

Trial Examiner: What did he say?

The Witness: He say no.

Q. (By Mr. Grodsky): Did you tell D'Amico that you had worked there on Friday before?

A. Yes, sir.

Q. And did you tell him who had told you to come down to the Union Hall? [27]

A. Yes, sir.

Trial Examiner: You got the job on Friday yourself?

The Witness: Yes, sir.

Trial Examiner: How about Jesse, was he with you, too?

The Witness: Yes, he was with me, too.

Trial Examiner: When you got the job you didn't go through the Union Hall?

The Witness: No.

Trial Examiner: You got it yourself?

The Witness: Yes, sir.

Trial Examiner: You were a member of the Union at that time?

The Witness: Yes, sir.

Trial Examiner: You paid your dues?

The Witness: Yes, sir.

Trial Examiner: And your dues were paid up at that time?

(Testimony of Monico C. Garcio.)

The Witness: Yes, sir.

Q. (By Mr. Grodsky): After that time, how long was it before you went to work on the Wilshire Terrace job?

A. After they stopped me?

Q. Yes. A. About seven weeks.

Q. During that period of about seven weeks did you go to the Union Hall looking for work?

A. Yes, sir, I put my name, and they give me a number, and [28] I report every day, 7:00 o'clock in the morning, until 9:30.

Q. What time did you report?

A. 7:00 o'clock in the morning.

Q. Until when? A. Until 9:30.

Q. Do they have a roll call there; do they call the names of the people who are in the Union?

A. Yes, sir, every day.

* * * * *

Q. (By Mr. Grodsky): During the time that you did not work on the Wilshire Terrace job, during that seven weeks, did you at any time during that time go back to the Wilshire Terrace job?

A. About twice.

Q. And did you talk to somebody about a job at that time? [29] A. I talked to Art.

Trial Examiner: The foreman?

The Witness: The foreman; and he told me again I could have the job if I could have the clearance. [30]

* * * * *

(Testimony of Monico C. Garcio.)

Cross-Examination

Q. (By Mr. Schullman): Mr. Garcio, you have been a member of the union for over a year?

A. Yes, sir.

Q. Before the Martin Brothers job, you had other jobs, didn't you? A. Yes, sir.

Q. And some of the other jobs you were sent out by the union? A. Excuse me.

Q. On some of the other jobs, you were sent out by the union? A. No, sir.

Q. You were never sent out by the union?

A. No, sir. [31]

* * * * *

Q. Now, the foreman who was present when the business agent talked to you the day of the, I think it was April 24——

Mr. Grodsky: The 21st.

Q. (By Mr. Schullman): The 21st; he was a foreman for Martin Brothers? A. Yes, sir.

Q. And he was the one who told you to go to the Union and get a clearance, didn't he?

A. No, sir, Ben told me to go and get the clearance.

Q. Who? A. Ben Gomez.

Q. Yes, what did the foreman say?

A. He said to go get it straight with the union and get the clearance and they would give me the job back. [34]

Q. Then the foreman did tell you to go to the union and get the clearance; the foreman also told you to get the clearance. A. Yes, sir.

(Testimony of Monico C. Garcio.)

Trial Examiner: First you spoke to Dan Gomez, then you spoke to the foreman, is that it?

The Witness: Well, they was with us.

Trial Examiner: They were both with you?

The Witness: Yes, sir.

Trial Examiner: Both the foreman and Gomez were talking to you and Jesse?

The Witness: Yes.

Q. (By Mr. Schullman): Was the same thing said to Mr. Gallego? A. Yes, sir.

Trial Examiner: Had you started work that morning?

The Witness: No, sir.

Trial Examiner: You were getting ready to start?

The Witness: Getting ready to start. [35]

* * * * *

Trial Examiner: You said you had never been at the Union Hall before you went to work for Martin Brothers?

The Witness: Yes, sir, I have been in the Hall after the trouble started.

Trial Examiner: Not before?

The Witness: Not before. [37]

* * * * *

Mr. Grodsky: All right, I propose a stipulation that Dan Gomez, who was mentioned here yesterday, is a representative, I don't know the exact title, I think it is Assistant Business Representative of Local No. 300.

Mr. Schullman: So stipulated, subject to excision, if I find it is not true.

Trial Examiner: So stipulated.

WILLIAM L. MARTIN

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Grodsky): What is your address, Mr. Martin? A. My business address?

Q. Yes.

A. 6206 South Wilton Place, Los Angeles.

Q. What firm are you connected with?

A. Martin Brothers. [44]

Q. What is the nature of that company, is it a partnership? A. Yes.

Q. Are you one of the partners of the partnership? A. I am one of the partners.

Q. And is the partnership—in what business is the partnership engaged?

A. Lathing and plastering contracting.

Q. And is the partnership a member of the Contracting Plasterers Association of Southern California? A. Yes, sir, we are.

Q. Does your firm have occasion to hire common laborers? By common laborers I mean general laborers or unskilled laborers?

A. Yes, sir, we do.

(Testimony of William L. Martin.)

Q. And have you given any instructions to your foreman regarding any method to be used, specifically in regard to the hire of common laborers?

* * * * *

The Witness: We have no specific instructions.

Q. (By Mr. Grodsky): What method does your firm use with reference to the recruitment of laborers? [45]

* * * * *

The Witness: They on occasion call the Union Hall for men, and sometimes, we hire the men as they come around the job asking for work, or possibly they are referred by someone that is already working on the job.

Q. Does your firm require that the common or unskilled laborers have a clearance from Local No. 300 before they can work for you?

A. No, we don't.

Trial Examiner: You said common or unskilled laborers?

Mr. Grodsky: Yes.

Trial Examiner: Does that mean the same thing as a general laborer?

The Witness: Yes. [46]

* * * * *

Cross Examination

Q. (By Mr. Schullman): Mr. Martin, you have done business [48] with Local No. 300 before this occasion, haven't you? A. Yes, we have.

(Testimony of William L. Martin.)

Q. And you have hired plaster tenders through them? A. Yes.

Q. And you have a contract with them for plaster tenders?

A. We have a contract through our Association, yes.

* * * * *

Q. Now, you also have a contract with the Building Trades, is that right?

A. No, I have not.

Q. You are familiar with the Building Trades master contract?

A. I haven't read it for several years. [49]

Q. You have worked under it?

A. I have at one time, yes.

Q. In fact, you are still working under it, aren't you?

A. I couldn't answer that question because I don't know the termination date of the contract, possibly it is several years old, I haven't recently signed——

Trial Examiner: What is your answer?

The Witness: I haven't recently signed any Building Trades contract. [50]

* * * * *

Q. (By Mr. Schullman): Now, Mr. Martin, with respect to Respondent's Exhibit No. 1 in evidence which I may show you again for a moment, will you read the last paragraph? [51]

* * * * *

(Testimony of William L. Martin.)

Q. (By Mr. Schullman): Isn't that known as a short form agreement? A. That is.

Q. Which takes into it the master agreement between the Building Trades and the various employers, if you know? [52]

* * * * *

The Witness: In 1946, apparently, there was a master agreement between the AGC and the six Basic Trades. That contract, I understand, has been renewed through negotiations from time to time. However, the terms and conditions of the contract of 1946 are not at all what they are today, so therefore, this is a short agreement which we are obliged to sign because we were not members of an AGC Association at that time, and we signed that contract for that particular term of the contract, not for any subsequent contract in later years.

Q. (By Mr. Schullman): As a matter of fact, Mr. Martin, you are not a member of the AGC now? A. That's right.

Q. You said at that time; you have never been a member of AGC?

A. Never been a member. [53]

* * * * *

Q. (By Mr. Schullman): You have been paying health and welfare payments on the laborers up to the present time, haven't you? A. Yes.

Q. And as a matter of fact you have been paying the laborers wages up to the present time, based upon the current laborers wages under the AGC contract? A. Yes. [55]

(Testimony of William L. Martin.)

Redirect Examination

Q. (By Mr. Grodsky): Mr. Martin, at the time when you signed that 1946 agreement which is in evidence, what was the nature of the business of your firm, or whoever it was that—strike that.

Was it Martin Brothers; I didn't see the agreement. It is signed by you, W. L. Martin; was Martin Brothers in business at that time?

A. I am not—I can't recall the exact turn-over time. I think it was about ten years ago that we changed from W. L. Martin Contractor to Martin Brothers. [56]

* * * * *

Q. What was the date of your—what was the nature of your business at that time, was it lathing and plastering work?

A. Well, we started out as a lathing and plastering contractor and during the war we had some government work and it was necessary to take out a Supplemental B-1 license, that is a general contractor's license, which I have at the present time, and the fact that we were hiring carpenters and other people besides lathers and plasterers made it necessary for me then to sign this contract, the short form contract of the six Basic Trades. We still carry the B-1 license, which is supplementary to our regular Lathing and Plastering license and we just keep that in the event that we would want to go into it at some other time.

(Testimony of William L. Martin.)

Trial Examiner: Do you employ any of the six Basic trades?

The Witness: At the present time, we have one operating engineer which we have a contract with; we have one carpenter on the payroll, and I don't think we have any agreement with the carpenters.

Trial Examiner: Is that a temporary thing with the carpenters?

The Witness: It is a temporary thing, yes.

* * * * *

Trial Examiner: Apparently the facts support the stipulation previously entered into with respect to Mr. Gomez, is that correct?

Mr. Schullman: Yes, so stipulated.

Mr. Grodsky: Call Mr. Sherman.

ARTHUR F. SHERMAN [58]

a witness called by and on behalf of the General Counsel, being first duly sworn, was examined and testified as follows:

Direct Examination

* * * * *

Q. (By Mr. Grodsky): By whom are you employed?

A. Martin Brothers Lathing and Plasterers Contractors.

Q. Will you please speak up a little?

On what project are you employed at this time?

A. The Wilshire Terrace, 10375 Wilshire Boulevard.

(Testimony of Arthur F. Sherman.)

Trial Examiner: What is your position?

The Witness: Lather foreman.

Q. (By Mr. Grodsky): I think it would be helpful if you tell us the approximate size of that project?

A. Well, what do you mean, in months or weeks or——

Q. How long has the project been in effect so far as the lath and plastering—your work, is concerned? A. About 9 months, so far.

Trial Examiner: How large a crew do you have?

The Witness: Oh, I had 13 laborers and 60 lathers at one time.

Q. (By Mr. Grodsky): When you say 13 laborers, most of those [59] are plaster tenders?

A. I got one plaster tender, he is a lead man like, and the rest are laborers.

Trial Examiner: Do you do hiring and firing?

The Witness: I hire and fire, yes.

Q. (By Mr. Grodsky): Do you know Mr. Garcio? A. Very well, yes.

Q. And he is a laborer, he is now working on the project, is that correct?

A. He is working now, yes.

Q. Do you remember when he first went to work on that project? A. In April.

Q. And did you hire him?

A. I hired him, yes.

Trial Examiner: Are we talking about Monico Garcio?

The Witness: Yes.

(Testimony of Arthur F. Sherman.)

Q. (By Mr. Grodsky): Do you recall what day of the week it was that he went to work?

A. On Friday.

Q. Do you recall whether in addition to him you hired anyone else on that day?

A. I hired one man, but I can't recall his name.

Q. If I suggest his name is Jesse Gallego——

A. That is the name.

Trial Examiner: You hired the two of them together? [60]

The Witness: Yes.

Q. (By Mr. Grodsky): They worked on that day, is that correct? A. Yes.

Q. They next appeared for work on Monday morning, is that right? A. That's right.

Q. And they didn't go to work on that day, did they? A. No.

Q. Will you tell us why they didn't go to work?

A. Well, the assistant business agent of the laborers local came out that morning and he said they had to go down and get a clearance through the local, Local No. 300, to stay on the job; I told the men that, to get a clearance and come back, come on back.

Trial Examiner: You said the assistant business agent came on the job; tell us what he said, did he say this to you?

The Witness: He told me these men have to get off the job because they have no clearance for the job.

Trial Examiner: Then what did you do?

(Testimony of Arthur F. Sherman.)

The Witness: I told them to go down to the local and get a clearance and come back and they had a job from there on.

Q. (By Mr. Grodsky): Did you have any other discussion with Mr.—do you know the name of the assistant business agent [61] who was there?

A. Gomez.

Q. Did you have any other discussion with him at that time about those men?

A. No, I told him they were very good men, I would like to have them back. That is what I told him.

Mr. Grodsky: Nothing further.

Cross Examination

Q. (By Mr. Schullman): Mr. Sherman, I presume that as foreman for the Martin Brothers for some years you have had contact with representatives of Local No. 300, is that correct, you knew them? A. Very well, yes.

Q. And from time to time they were with the business agent concerning plaster tenders?

A. Yes.

Q. And from time to time concerning laborers, is that right? A. Yes.

Q. You knew that they had a hiring hall and a registration system down there?

A. I did, yes. [62]

* * * * *

JOSEPH D'AMICO

a witness called by and on behalf of the Hod Carriers, being first duly sworn, was examined and testified as follows:

Direct Examination

Q. (By Mr. Schullman): Mr. D'Amico, you are the business representative of Local 300?

A. Yes.

Q. What is your exact title presently?

A. Acting field manager. [67]

* * * * *

Q. Now, with respect to the—by the way, Local 300 has how many members?

A. 15,000 or better.

Q. You have divided into two categories, laborers—— A. And plaster tenders.

Q. Does the same Local 300 have membership of both? A. Both, yes. [68]

* * * * *

Q. Will you tell us very briefly the practice of short form practice, and how the subject trades operated thereunder?

A. The short form agreement is operated, the laborers representative, business representative, or carpenters business representative, or any of the craft, can sign a contract under this short form.

Anybody that signs the short form, he is covered with the laborers with all crafts of it. That is what they call a short form. In other words, the man doesn't belong to association, or which we have in

(Testimony of Joseph D'Amico.)

Los Angeles, we have four different associations here. We have AGC, BCA, HBA, and EGCA.

Q. Now, for the record, will you spell out what those are, the four associations?

A. That is the AGC is——

Q. Is that Associated General Contractors?

A. That is right; and BC is Building Contractors Association. HBA is Home Builders Association; and EG, Engineers, EGCA, engineers, General Contractors.

Q. Now, Mr. D'Amico, the AGC, if you know, now has I think six basic trades?

A. That is right.

Q. And has, if you know, how many subtrades?

A. I really couldn't tell you that.

Q. Are the laborers one of the subtrades? [73]

A. Yes. We are one of them; we are the main ones, not one of them.

Mr. Grodsky: Not a subtrade?

The Witness: We are the basic trades; we are the basic trades.

Q. (By Mr. Schullman): Where the employer is not a member of the association, he signs a short form agreement? A. That is correct.

Q. With the AGC?

A. No. With the building trades, that is right, short form.

Q. And then that short form merely relates to the general master contract of building trades?

A. That is right. [74]

* * * * *

(Testimony of Joseph D'Amico.)

Q. (By Mr. Schullman): Now, under the short form agreement signed with Martin, Mr. Martin, and the AGC, the laborers and the other six trades operated thereunder; is that correct?

A. That is right.

Q. Now, when operating thereunder, what terms, or what conditions would you use, which contract would you operate under?

A. Under the master agreement of the AGC. That is the only way we can operate. [79]

* * * * *

Q. All right. Now, let me break down physically, you have how many members in Local 300?

A. Right now we have at least 15,000.

Q. And to break that down, how many would you say are plaster tenders and how many laborers, roughly?

A. Roughly, around 1500 plaster tenders, we have.

Q. The greater majority are laborers?

A. Oh, yes, laborers and mason tenders, and so forth.

Q. Now, your main office is located where?

A. 2005 West Pico, Los Angeles.

Q. And you have, that is your central office?

A. That is our main office, central office.

Q. Where is your main dispatching room?

A. Downstairs in the hall, big hall we have. [116]

* * * * *

(Testimony of Joseph D'Amico.)

Q. Now, as a practical matter, when that short form is used, and calling attention to this short form, who gets it signed, if you recall, the AGC or the Laborers Local? [119] A. The short form?

Q. Yes.

A. The short form anybody can sign the short form, and then all the trades come under it. A carpenter can sign it, and the laborers can sign it, and carpenters come under it.

Q. Who gets it signed?

A. Any business agent.

Q. Of your local or any local?

A. Any local. [120]

* * * * *

Q. (By Mr. Schullman): Now, with respect to the union, itself, if the short form is signed, and calling attention to R-1, what is done, if anything, with respect to requiring the employees in this case of Martin to become a member of, to become members of Local 300?

A. Well, he has to, when he becomes, when he signs the short form, if he, if he has non-union laborers on the job, if he has non-union members on the job, we sign them up and give them a clearance, because it has been the practice of our area, and from then on, he calls the hall for his men, and we give the first men off the board. [121]

* * * * *

RESPONDENT'S EXHIBIT No. 1

No. 43627

Los Angeles, California
July 18, 1946

ARTICLES OF AGREEMENT

Entered Into By And Between W. L. Martin, hereinafter known as the Contractor, and the Building and Construction Trades Councils of The Twelve (12) Southern California Counties, hereinafter known as the Council. For the purpose of clarification, the twelve (12) Southern California Counties are herein enumerated as follows: Los Angeles, Inyo, Mono, Orange, Riverside, San Bernardino, Imperial, Ventura, Santa Barbara, San Luis Obispo, Kern and San Diego.

The Contractor does hereby agree and affirm that he will employ or cause to be employed upon any and all work which comes under the jurisdiction of the Councils named in Paragraph 1 above on all work performed by said Contractor or his subcontractor in the jurisdiction of said Councils and their affiliated Unions, only members in good standing in the organization to which said work properly belongs in accordance with the wage scales, classifications and working rules of the Union having jurisdiction.

The Contractor further agrees that before starting said work in the jurisdiction of any of the Councils enumerated in Paragraph 1 of this Agreement, he will contact the Council in the jurisdiction where

Respondent's Exhibit No. 1—(Continued)

the work is to be performed and will comply with the requirements of the Council and its affiliated Unions for clearing workmen to the job before said workmen are put to work thereon.

The Council in the locality where the work is to be performed, agrees to furnish to the Contractor competent mechanics in all branches of the industry, upon any and all work done under the direct supervision of the Contractor. Upon all work done on a subcontract basis, the Council agrees to furnish successful subcontractors competent men in all branches of the building industry. Should an occasion arise wherein the Council is unable to fulfill its part of this Agreement, then the Contractor, or his Agent for him, shall be allowed to employ whomsoever he may choose, provided, however, such workman or workmen so employed shall signify their willingness to abide by the rules and regulations of the Union to which said workman or workmen properly belong, by filling out an application, paying the necessary fee and depositing same with the proper Union. Upon all work either direct or contracted, there shall be no stoppage of work on account of a jurisdictional dispute. If any jurisdictional dispute arises it must be settled through the Council and the Building Trades Department of the American Federation of Labor, and both parties signatory hereto shall immediately comply with the decisions rendered.

It is mutually agreed by the Contractor, Councils, and their affiliated Unions that they recognize the

Respondent's Exhibit No. 1—(Continued)

need for apprenticeship training and to this end shall indenture apprentices in each of the trades employed, in conformity with Section 1777.5 of the Labor Code of the State of California governing employment of apprentices on public work.

This agreement shall become effective at the date hereof and remain in full force and effect for a period of one year and from year to year thereafter, unless either party has given sixty (60) days written notice to the other party, prior to the termination date, that it desires to terminate, amend or modify said Agreement.

LOS ANGELES BUILDING AND CONSTRUCTION TRADES COUNCIL

/s/ L. A. MASHBURN,
L. A. Mashburn, Secretary

/s/ By L. A. VIE,
Business Representative
536 Maple Ave., Room 202
Los Angeles 13, Calif.
MIchigan 0678

/s/ W. L. MARTIN
Contractor
6206 So. Wilton Pl., L. A. 44,
PL 14455
Classification C-35 S-B1
License No. 67612

Admitted in Evidence December 3, 1958.